INTERSTATE BANKING AND BRANCHING

HEARING

BEFORE THE

SUBCOMMITTEE ON
FINANCIAL INSTITUTIONS SUPERVISION,
REGULATION AND DEPOSIT INSURANCE

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

FIRST SESSION

OCTOBER 26, 1993

Printed for the use of the Committee on Banking, Finance and Urban Affairs

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INTERSTATE BANKING AND BRANCHING

TUESDAY, OCTOBER 26, 1993

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
SUPERVISION, REGULATION AND DEPOSIT INSURANCE,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:15 p.m., in room 2128, Rayburn House Office Building, Hon. Stephen L. Neal [chairman of the subcommittee] presiding.

Present: Chairman Neal, Representatives LaFalce, Vento, Flake, Orton, Klein, Maloney, McCollum, Baker, Nussle, Johnson, Pryce, Grams, and Huffington.

Chairman NEAL. Let me call the subcommittee to order at this time and welcome everyone to today's hearing, which I anticipate will be the subcommittee's last on interstate banking and branching issues. Today we will hear from administration representatives. After reviewing your written testimony, Mr. Newman, Mr. Ludwig, I can say I wholeheartedly agree with you about the benefits of liberalized branching laws. Interstate branching will allow customers and businesses better access to banking services. Interstate branching will enable banks to cut costs and use the savings to make more loans and improve their capital positions. Interstate branching will permit banks to better insulate themselves from regional downturns by allowing them to better diversify both their loan portfolios and their sources of deposits.

I also agree with you that some of the concerns about interstate branching have been greatly exaggerated. The durability of small banks in States that have long permitted full statewide branching amply demonstrate that community banks will survive and prosper in a world of interstate branching and banking.

Concentration concerns are often overstated because mutual funds, securities firms, insurance companies, and other financial services providers increasingly compete with banks to attract deposits and make loans. Finally, there is no indication that interstate branching would accelerate the flow of funds in and out of communities that currently takes place via mutual funds, bank investment and securities, and sales of Fed funds.

In short, the administration has made a convincing case that interstate branching legislation is clearly in the national interest, but I am a little confused about the shape of the interstate branching proposal the administration will support. In this and previous Congresses, a number of different interstate bills have been introduced, including consolidation measures by Congresswoman

Maloney and by myself and a broader proposal which Congressman Vento has authored and which I cosponsor.

I hope we can get down to specifics and clear up some of the confusion about the administration's position in the course of today's hearing. In addition, while I greatly appreciate the administration's effort to set priorities, I hope it will be flexible on timing and will not insist that each priority for financial services legislation be enacted in the exact order Secretary Bentsen articulated yesterday.

I agree that community development banks, fair trade and financial services, regulatory restructuring are important issues, but work in Congress on interstate branching may well be more advanced than it is on some of these other issues. We should not pass up golden opportunities to act in one area simply because efforts in others may be lagging.

That said, I am certainly delighted that both of you could join us this afternoon inasmuch as we share a common belief in the wisdom of liberalizing interstate branching laws. I look forward to working with you to craft a bill that achieves that objective, thereby reaping the many benefits you have so ably enumerated in your testimony.

It is a real pleasure to have both of you with us today. You are both doing outstanding work, and I appreciate that also, and I welcome you. Before starting the testimony let me yield to others on the subcommittee who may have statements to make.

Mr. McCollum.

Mr. McCOLLUM. Well, thank you very much, Mr. Chairman. I certainly agree with Chairman Neal's comments about you and the fact you are here and the great respect that we both share for you. I also agree with his comments about the concern he shares with me over the issues of what we proceed with and what we don't and what the priorities are.

In reviewing Secretary Bentsen's speech yesterday, it strikes me that there were specific orders of priority set forth in that speech. Maybe I am misreading them, but I read: One, finish RTC; two, pass the Community Development Bank bill; three, pass the Fair Trade Financial Services bill; four, regulatory consolidation; and, five, interstate branch consolidation.

In the context of the hearing we are embarking upon today, I find it interesting that it is interstate consolidation that is being pushed by the administration and not interstate branching and not the full interstate banking that I think both Chairman Neal and I believe is achievable. That is especially true in light of the fact that we have passed through both Houses of Congress in other years the full interstate branching, albeit combined with other things that have kept it from becoming law.

It is my opinion, and I think it is shared by a wide number of members of the subcommittee, that if we avoid some of the issues that would get us involved in other committee and subcommittee jurisdictions that we could pass full interstate branching and that we do not need to be concerned only with the consolidation.

I hope that the administration is open to this as well as to the consolidation, and last, but not least, on our side of the aisle, there is a strong sense that we must pass some variation pretty close in

line with Mr. Bereuter and Mr. Bacchus' regulatory relief legislation to go hand in hand with any interstate legislation that we do.

One without the other is not palatable considering the ramifications involved in interstate and the concerns that bankers naturally have with the regulatory issues. So I am hoping that out of not only what we say today, but down the road that we can truly put together some bipartisan legislation that will achieve both of those objectives or maybe three of them since consolidation has been broken out. The three objectives then would be: Full interstate branching, the consolidation that is needed, and the regulatory relief. If we can do that in this Congress, that alone would be a very significant achievement, and an advancement of, I think, what all of us would probably believe personally as well as politically are good causes. Thank you.

Chairman NEAL. I thank the gentleman. I think he is absolutely right about the potential cost savings for this interstate legislation. I mean, I have seen estimates. I have been saying that the industry would save hundreds of millions of dollars. I have recently seen an estimate that it could be as high as $10 billion that would be nice if we could do it.

Mr. LaFalce.

Mr. LAFALCE. Those are good numbers. Let me just say that I am very pleased that the administration is pushing some key banking reforms to the front of its legislative agenda—in particular interstate branching. Our current inefficient system requires multi-State bank holding companies with banks in several States across the country to set up totally separate corporate structures in each State they serve rather than simply establishing branches. It just doesn't make sense.

These banks are being forced to spend millions on corporate bureaucracy that could be far better spent on consumer or business loans. There are few actions that could help end the credit crunch more than a sensible interstate branching policy. However, I do think we must do far more, and I would urge the administration to develop and push for a comprehensive financial services modernization proposal—not necessarily have it on the same timetable as interstate—but I think it would be good to have it out there. There is nothing very much new in the world. Such a modernization proposal would probably be very similar to what President Carter advocated, President Reagan advocated, and President Bush advocated.

Once you assume a position of responsibility and power, all of a sudden you seem to see the light regardless of political persuasion. It would be good to get it out there—the vision—and then proceed incrementally if that is the best way to proceed politically. But allowing for greater geographic diversification is just not going to be sufficient to solve the banking industry's problems, and we all know that.

Unless our banks can follow their customers into the new markets, such as mutual funds, securities, and insurance, they are not going to be able to maintain adequate profitability or their central role in our financial system, and I think they need to do both. It is going to be in the best interest of the consumer—the individuals and businesses who are the bank's customers. They are going to re-

ceive the primary benefit of these modernization proposals, and as soon as we can get on with it, the better. Thank you.

Chairman NEAL. Mr. Johnson.

Mr. JOHNSON. Thank you, Mr. Chairman. I am glad these people are here today. I think interstate banking in one form or another is inevitable, and I think we realize that, as Mr. LaFalce has said, you know, well capitalized financial institutions should be allowed to set up branch banks in other States.

I am disappointed that the President is not getting behind that. Many smaller and independent banks, however, have expressed concerns that interstate banking will put them on an uncompetitive footing, and I think that is a legitimate concern as well. I think that now is the time to consider not only branch banking nationwide, but as well a little bit of leeway for the smaller banks so they are not hit with thousands of examiners and regulations.

I think Mr. Bentsen talked about it when he talked about the case where there were 26 examiners looking at one bank and they couldn't even get in the bank because they had all the parking places tied up, so, you know, it seems to me that his statement is right on target when he says there are impediments that can be removed and we have anachronistic, inconsistent, and sometimes excessive legislative and regulatory restrictions in our financial system. That is Mr. Bentsen's statement. I adhere to that. I think he is right on target.

We need to remove those as part of this legislation. I don't think there is anybody on this subcommittee that would deny that. I thank you for being with us today. Thank you, Mr. Chairman.

Chairman NEAL. I thought we would go ahead and see how far we can go with these opening comments, then we can come back and hear the testimony.

Mr. Orton.

Mr. ORTON. Thank you, Mr. Chairman. I will be very brief. I would like to, first of all, express my thanks to you for your leadership on this issue. Since I came to Congress 3 years ago, you have been one of the leaders in speaking on this issue and bringing it to our attention, and I appreciate the hearings that you have put together and I thank Mr. Newman and Mr. Ludwig for coming over and sharing your knowledge on it. I shared some of the same concerns as Mr. McCollum in identifying exactly what you mean by interstate consolidation.

As I read your testimony, Mr. Newman, I understand you to say that you favor the consolidation of branches under the same company in different States but apparently would not favor de novo branching creating new branches in another State. That distinction, if drawn, I am wondering if maybe in your testimony you can describe how far you go if, in fact, you don't allow—if you would allow the acquisition of a bank inside a new State and then consolidation, it seems to me that we are distinguishing between starting a new operation or going and buying an existing operation.

If we don't allow the acquisition of that new—that bank in consolidation, then all we are doing is grandfathering those banks that are already out there in interstate branching, and so I am a little concerned about where the administration would draw the line in what we are calling interstate consolidation as opposed to full

interstate banking and branching. I would like to hear some further detail from both of you as to what you would recommend in those areas.

I think you have done very well in your written testimony and I look forward to your oral testimony, so thank you, Mr. Chairman.

Chairman NEAL. Thank you.

Mr. Nussle.

Mr. NUSSLE. I don't have an opening statement, Mr. Chairman. Appreciate the hearing. Thank you.

Chairman NEAL. Thank you, sir.

Mr. Klein.

Mr. KLEIN. Thank you very much, Mr. Chairman. First of all, I want to say how much I appreciate the work of both Mr. Ludwig and Mr. Newman. I have had an opportunity during the course of my brief tenure in Congress to work with both of them, and they have just been splendid and, of course, their public performance has been even more splendid. I want to congratulate the chairman on his leadership on this very, very important subject.

On the question of interstate banking, I, at the present time, have an open mind on the subject. One of the questions that I have is the one that I share with Mr. Orton as to precisely what is being proposed by the administration. But regardless of what is being proposed by the administration, be it consolidation or some broader concept than that, it seems to me that the banking system, while we certainly want it to work better for the banking industry so that the banking industry can eliminate unnecessary costs and achieve more efficiency, the ultimate desire, at least on my part, and I think on the public's part, is that we have a banking system that better serves the public and better delivers much needed capital to our system. And one of the things that I would like very much to know is whether interstate banking in whatever form it may ultimately be recommended is going to achieve that ultimate objective.

I thank you very much, and I look forward with great anticipation to your testimony.

Chairman NEAL. We have about 4 minutes, Mrs. Maloney. Do you want to take 1 minute?

Mrs. MALONEY. Yes, I do, Mr. Chairman.

Chairman NEAL. Do you want to wait until we come back?

Mrs. MALONEY. I will just go ahead and do it now and run. Maybe I should wait until we come back. What do you think?

Chairman NEAL. It would give you a little more time. Let us recess about 10 minutes. We will be right back.

[Recess.]

Chairman NEAL. I would like to reconvene the subcommittee. Now, I know Mrs. Maloney wanted to comment on this because she has a bill in that would allow consolidation, but she is not—oh, here is Mrs. Maloney.

We were just going to hear from Mrs. Maloney when we left, so let me call on her at this time, then we will go to the other members who are here.

Mrs. MALONEY. Thank you very much, Mr. Chairman. Today's hearing seems particularly timely given the statements yesterday by Secretary Bentsen on this very issue. As many of my colleagues on this subcommittee are aware, I have been speaking for some

time about taking an incremental approach to interstate banking and branching.

At virtually every previous hearing of this subcommittee I have questioned witnesses about the idea of passing interstate consolidation legislation as a prelude to other future Interstate Banking bills. To that end I introduced H.R. 3129, the Interstate Bank Consolidation Act of 1993. I was, therefore, greatly pleased that Secretary Bentsen yesterday called for adopting this very same approach to interstate banking.

I feel that it would streamline, allow the banks to have more money to put into consumer loans. There is absolutely no reason why we haven't already passed this. This morning many of us joined Vice President Gore at a signing of reinventing government, the procurement reform legislation that tries to streamline government, cuts out red tape duplication in order to be leaner and more competitive. That is what this bill would do for the banking industry, and I hope that we will pass it very soon. Thank you.

I look forward to hearing from Under Secretary Newman and Comptroller Ludwig as they elaborate on the administration's view of interstate consolidation and their ideas about achieving this consolidation. Thank you.

Chairman NEAL. I thank the gentlelady and thank her for her leadership on this issue.

Mrs. MALONEY. Thank you, Mr. Chairman.

Chairman NEAL. Ms. Pryce.

Ms. PRYCE. Thank you, Mr. Chairman. I really have no statement at this time.

Chairman NEAL. Thank you, ma'am.

Mr. Flake.

Mr. FLAKE. Thank you very much, Mr. Chairman. Let me just welcome Mr. Ludwig and Mr. Newman to this subcommittee. As you know, several years ago this was an issue you and I joined together and stood on the forefront on in relationship to interstate branching. I think it is an issue whose time has really come.

We need to move the banking industry out of the dark ages, deal with the reality that people are moving beyond geographical boundaries to do basic kinds of banking functions and to do work functions. They should be able to in whatever environment they find themselves be able to know that if they are dealing with a particular bank and that bank has that name, that bank has a branch that regardless of what State they are in they should be able to do services, and so I think we are moving in the right direction, coming from a tri-State area like I do, Connecticut, New York, and New Jersey, where there is so much of an intermingling of various functions, the reality is I think it is helpful not only from the perspective of what it does in terms of the banking industry itself, but what it does for the consumer.

I think it is a good step, the right step, and it is one that we ought to take. I am in full support and hope that we can move the bill along.

Chairman NEAL. Thank you, sir.

Mr. Grams.

Mr. GRAMS. Thank you, Mr. Chairman. I don't have an opening statement. I just want to welcome the witnesses and look forward to hearing their testimony. Thanks very much.

Chairman NEAL. Mr. Vento.

Mr. VENTO. Mr. Chairman, I am sorry I was late. I was chairing another committee. We, obviously, had the vote. I welcome Under Secretary Newman and Comptroller Ludwig. I look forward to the testimony and to a clarification of the administration's position on the future of our banking system.

Frankly, this morning's paper and news reports, to me, don't provide, I think, the type of coherent, clear understanding that is necessary in this issue with regards to interstate and branch banking. If the administration position is to more or less freeze in place the current status quo with some liberalization within it, such a configuration raises fundamental questions of fairness and efficient functioning of our economy, consumers, banks, and the Federal insured Bank Insurance Fund.

Permitting a consolidation only in the States where banks are already located restricts competition, denies consumers choice, and will result in large regional monopolies. If the Congress takes this half step which you have reportedly advocated, full interstate banking and branching may never be realized, much less a rational banking system, nor will this provide a safe harbor for consumers, rather a distorted marketplace filled with pitfalls.

I am sympathetic to many of the goals you have enunciated. I agree that the States must have a positive role in the process, not only in terms of permitting banks to branch, but in setting appropriate and nondiscriminatory requirements. Consumers in local communities have vital interests in this issue. Clearly, consumer rights must be protected, safeguards must be set in place to ensure the interstate branch participates in the local community and not siphon away limited capital.

Regulatory safeguards should be enacted. Needless to say, I will just put the rest of my statement in the record, but I did want to get down. I apologize for being busy. Now, they want me on the floor to do the biologic survey. As the foremost entomologist in the House, I have a lot of responsibilities. In any case, I had a good rapport with the two witnesses, and I am certain that there will be clarification at this hearing.

I will try to stick around to at least hear your opening salvo. Mr. Chairman, thank you.

[The prepared statement of Mr. Vento can be found in the appendix.]

Chairman NEAL. Thank you, sir, very much. I don't know if our distinguished witnesses know or not, but it was Mr. Vento's bill that passed the House overwhelmingly a few years ago.

Mr. VENTO. It was actually an amendment, but I think it was in 1991 that Chalmers Wylie and I worked with yourself and many others to craft together interstate branching and banking provisions that received acceptance by the House floor, but it was attached to some other minor changes in law which in its totality was too much to digest for the House or anyone else, so——

Chairman NEAL. But anyway, it is an approach that, frankly, makes more sense to me than the limited approach, and I hope we

can get your full support on that. I just want to remind everyone, it did pass the House overwhelmingly with just a handful of votes against it. I thank the gentleman.

Mr. Huffington.

Mr. HUFFINGTON. In the interest of time, I would pass.

Chairman NEAL. Thank you, sir, very much.

Mr. Baker.

Mr. BAKER. I will be real brief. Thank you, Mr. Chairman. I just wish to make a comment to those who will testify in a moment that I certainly applaud the effort to put forward the concept of interstate activities under whatever framework may ultimately be proposed. I would just suggest that given the limited remaining congressional time available that more likely that something of this volatility would perhaps move to next semester's schedule.

That being the case, I would hope that we perhaps would view the world in a broader set of parameters, that we cannot touch interstate without opening other doors. If we are going to open them even a little, we ought to go ahead and bring everybody into the dormitory and discuss what the financial marketplace ought to look like in the next decade rather than continuing to piecemeal the marketplace, and I just make that as a caveat to what I know is an important comment by both of you on the need for interstate expansions, but I hope that during the remaining months between now and perhaps next spring that perhaps a broader based agenda could be developed that really needs to be addressed, and I thank the gentlemen for their efforts.

Chairman NEAL. I would like to, without objection, like to put a statement in the record by Mr. Kennedy who supports the interstate banking legislation and who also comments on the need for a strong consumer protections, but I did want to point out that he does have a strong statement in favor of the legislation also.

I think we have heard from everyone who is here and now it will be a real pleasure to hear from our distinguished witnesses.

First, Mr. Frank Newman, Under Secretary for Domestic Finance, the Department of the Treasury; then the Honorable Eugene A. Ludwig, Comptroller of the Currency. We will put your entire statements in the record, and ask that you summarize so that we will have a little time for questions and answers. Welcome, gentlemen. I look forward to hearing from you. Mr. Newman.

STATEMENT OF FRANK N. NEWMAN, UNDER SECRETARY FOR DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY

Mr. NEWMAN. Thank you, Mr. Chairman, Mr. McCollum, members of the subcommittee. I will try to summarize the best I can here and cover the key points, and to the extent possible, clarify some of the open issues that some of you referred to as best I can, and obviously we would be happy to respond to questions afterwards.

I am pleased to discuss with you the administration's views on the geographic restrictions imposed on commercial banks in the United States. These restrictions are unique among industrialized nations of the world, and many observers consider them among the least defensible of our banking laws. Last week I spent a little bit of time at a Brookings Institution conference that was inter-

national, and we did a count. There were people there from 16 different countries, and at one point I asked them if people could raise their hands as to who was from a country that placed any geographic restrictions on the locations of its banks, and one person raised his hand. I said, "What country are you from?" He said, "The United States."

The administration, as you know, supports the idea of relaxing these geographic restrictions, and as Secretary Bentsen stated yesterday, in my testimony today I will explore some of the reasons for that conclusion, discuss the concerns most commonly raised with respect to geographic liberalization, and provide the administration's views on key issues with respect to interstate banking and branching.

From the administration's perspective, the process on this important issue is still in its early stages. I am not planning today to comment on specific bills, some of which were introduced very constructively by the chairman and other members of this subcommittee. Nor am I planning to comment on every provision and issue addressed by these bills.

We look forward to examining these matters, discussing them with constituents with genuine and relevant public policy considerations, and working with you as the process proceeds. We no longer find the current framework of geographic restrictions appropriate for several reasons.

First, modern banks operate beyond local markets, and they compete with nonbank institutions that face no similar geographic restrictions.

Second, the States themselves have relaxed geographic barriers.

Third, removing these restrictions could improve the safety and soundness of the banking system.

Fourth, the public could benefit from greater competition, improved bank performance, and greater customer convenience.

Finally, removing geographic restrictions would give banks the flexibility to structure themselves more efficiently, which could permit banks to make more credit available for businesses and consumers. On balance, geographic restrictions have outlived their usefulness and no longer reflect bank practice or competition. Rather, they require banks to organize themselves in cumbersome and inefficient ways.

The States have already come to recognize these inefficiencies of geographic restrictions. Today 46 States plus the District of Columbia permit statewide branching. Four States continue with limited branching, and no State retains the old unit banking concept. Currently, all States except Hawaii allow out-of-State bank holding companies to acquire banks within those States.

Just a brief comment on safety and soundness, and I know Comptroller Ludwig will comment on this, too, but we do believe that relaxing geographic restrictions would promote safety and soundness in the banking system. It would allow banks to diversify their assets geographically more easily which promotes an aggregate income flow that is more stable than that from each area taken individually.

The earnings of geographically limited commercial banks are more susceptible to the vagaries of local market cycles which

render such banks more likely to fail. In fact, a large number of the bank failures of the 1980's involved institutions which were overcome by regional economic weakness. Also, to the extent interstate consolidation and branching reduces operating costs, bank profitability would increase. This would help banks build their capital accounts, directly contributing to overall safety and soundness.

Customer convenience would also be improved. Secretary Bentsen noted yesterday the example of customers right here in this geographic area where a single banking company might have a bank subsidiary here in the District and another one in Maryland and another one in Virginia, and they are legally separate, and the customer is inconvenienced if he or she lives in one part and works in another and actually can't bank in a full sense in each of those areas. If we had a foreign visitor come and look at this they would think it was just extraordinarily bizarre.

It is really ironic because at this point in time Europe is going through some changes where they are actually going across national lines and actually trying to make it more convenient for people to be able to bank with their banks when they cross a national border, not just a State border.

With respect to efficiency, a number of banking organizations and bank analysts argue strongly in favor of the cost savings that bank holding companies could realize through consolidation via interstate branching. Banks could achieve these cost savings largely by reducing the expenses of duplicative functions. While the amount of savings may vary from one bank to another, we are convinced, and I am personally convinced from my own experience that very substantial efficiencies can be realized by many of these institutions.

There are a number of concerns that are commonly raised with respect to geographic liberalization. Included among them are that it might lead to a decline in the number of small banks, that it might result in an excess concentration of resources, that it might siphon credit from local communities, and that it might damage the dual banking system.

I would like to address each of these a little bit. One of the most frequently voiced concerns is that interstate branching somehow would inevitably reduce the number of banks, that large institutions would enter local markets and drive out all the small community banks or buy them out. However, ample evidence indicates that this outcome is not inevitable or even likely.

For example, in States where intra and interstate geographic restrictions were significantly relaxed over the years, such as New York, small banks have continued to prosper. Even in States that have long had liberal branching laws, like my home State of California, small banks prosper and compete successfully with large banks.

For example, it has been literally since the early 1900's that California has had branching throughout the entire State, a very big State, but there are literally hundreds of small banks, as well as many, many thrifts and credit unions that operate alongside the banking organizations that have far-reaching branch networks.

Other longstanding branching States also have strong, small bank communities.

A longstanding concern with respect to the removal of geographic restriction involves the potential concentration of banking resources and its effect on competition. While this concern cannot be dismissed lightly, new measures to limit concentration are not necessary and would be extremely difficult to define by statute in a meaningful way.

Despite progressive consolidation at the State and national levels, the level of concentration in local, urban, and rural markets has remained virtually unchanged for almost two decades. The Federal regulatory agencies regularly examine bank merger and acquisition transactions for competitive effects, and this remedy, the bank regulators and the Justice Department, will remain in effect in the event of further relaxation of geographic restrictions.

Another concern raised is that interstate branching might undermine the intent of the Community Reinvestment Act and siphon funds from local communities, but interstate branching legislation need not alter the CRA. All existing requirements for community reinvestment will remain intact and serve to ensure that banks meet local credit obligations.

Also the siphoning argument has a double-edged tinge to it. A bank can also inject credit into an area and bring funds into local communities. This is among the reasons why States liberalized their branching and interstate banking laws. That is, broader geographic expansion authority can produce more efficient credit distribution, including a greater flow of funds to communities where the demand for credit is greatest.

Another concern that has been raised is that interstate branching would somehow damage the dual banking system, but that, too, should not occur. Current legislative proposals for interstate branching generally preserve States' authority to determine banking structure and otherwise regulate financial institutions within their jurisdiction. Under these proposals States would continue to control branching inside their States.

These proposals also permit States to impose on banks and branches within their borders certain State laws regarding fair lending practices, unsafe and unsound banking practices, and community reinvestment requirements. As I mentioned earlier, the administration supports the idea of further relaxing geographic restrictions, but in that process we believe that certain principles should be adhered to, which include: One, promoting efficiency and competition; two, protecting safety and soundness; three, meeting consumer and community needs; and, four, respecting the interests of the States.

Additionally, we believe that legislation to relax geographic restrictions should be kept separate from other issues so that it can be considered on its own merits.

We believe it would be consistent with these principles to allow multistate banking organizations to consolidate their bank subsidiaries. Individual States could be given the right to opt out of this policy if they affirmatively choose to. It would probably be only fair to provide that if a State does choose to opt out, then bank holding companies headquartered in that State would not be eligible to consolidate their banks in other States.

Consolidation would permit these organizations to structure themselves more efficiently, reducing overall banking system costs. It would benefit consumers and businesses through lower costs and greater convenience in the market for financial services. Moreover, simply consolidating interstate banks that belong to a bank holding company will not change the amount of banking assets under common control and should not raise any new issues regarding concentration.

I would also like to clarify a matter that some of you raised just today. We are talking here about permitting any bank subsidiaries at any time after the applicable start date, whenever the start date would be for consolidation, to be consolidated unless the applicable State opts out of the program, so this would apply to a bank that was owned today by a banking company or a bank that might be owned in the future in a given State by a banking company.

The principle of consolidation, we would suggest, ought to be adhered to at any point in time. We also believe that the issue of market share limits and other concentration safeguards demands further analysis. As I mentioned earlier, modern banks engage in a wide variety of activities and compete with a variety of nonbank financial intermediaries. Because of this, determining the appropriate limits on market share or even the proper definition of market can be complicated.

We have a strange situation. If you look at any given market, and this is something the regulators and the Justice Department deal with regularly, you say, well, there are banks there, there are thrifts, there are credit unions. In addition every individual who lives there and even businesses have the opportunity to put their funds into money market mutual funds, many of which actually provide check-writing features. So if you start with a concentration limit that is as narrowly defined as deposits in banks, you will miss an awful lot of what is going on in the real world and have a measure that simply isn't meaningful.

There are yet other complications. A lot of banks book out-of-State corporate business on their books in a particular State. For example, a bank that was located in New Jersey, did a lot of business with New York corporations, and happened to book its corporate deposits in its New Jersey bank. If we simply took a measure of the total amount of that bank's deposits compared to the market in New Jersey, we would have a distorted measure. We wouldn't really be looking at apples and apples. We wouldn't be looking at how much of the business for New Jersey residents is conducted by that particular bank. We would have a measure that literally you couldn't tell what it meant without analyzing it in much greater depth.

I have been through this numerous times with the bank regulators, with the Justice Department, and it takes very careful analysis and a simple numerical formula is almost impossible to make work, and also, we believe just not necessary. The process that the regulators go through right now, and the Justice Department goes through, is quite thorough, and it not only looks State-by-State, it looks market-by-market, which is even more important.

You need to look at a metropolitan area or a rural area within a given State. For these reasons we believe it is better to continue

to rely on the reviews of merger and acquisition transactions by the appropriate Federal agencies.

We are also very serious that any relaxation of geographic restrictions not undermine banks' obligation to serve their local communities. In this respect it is useful to emphasize that all existing CRA requirements will remain in effect. A final concern here is that interstate consolidation of banks into branch systems might reduce the availability of information on banks in their communities. These matters will be addressed in the new performance-based CRA approach currently being developed by the regulatory agencies and Comptroller Ludwig is leading a great deal of that effort, and I am sure he would be happy to respond to any questions you have.

Finally, any legislation enacted must provide foreign banks with national treatment—the same competitive opportunities as U.S. banks.

In conclusion, we believe relaxing current geographic restrictions should yield a number of benefits. Banks could benefit from greater efficiency. Businesses and consumers should benefit from less costly financial services and greater locational and product convenience. The banking system should benefit from improved safety and soundness.

Mr. Chairman, I commend you and the other members of the subcommittee for the seriousness and commitment you bring to this important issue. We look forward to working with you to achieve our common objectives.

Just one more issue that is not in my prepared text here, but it was raised earlier and I may as well respond to it now. Part of our thinking in terms of the sequence, although we clearly do support a great deal of what you are trying to do here, was that the RTC bill is well along at this point in time. It has passed both Houses of Congress. Hopefully, it will go into conference shortly, and we think it is very important to get that bill done and passed.

The Community Development Financial Institutions bill is something that we testified on some weeks ago. There has been quite a bit of time for people to think through the issues. We also testified on a balanced program of regulatory burden reduction. The Senate Banking Committee actually passed a combination of those two things by a bipartisan 18–1 vote. We think these can be brought to completion and passage relatively quickly, and we are just recommending that concentration be in those directions in terms of time sequence.

In the meantime, we would be very pleased to work with you on the various aspects of these interstate matters. Mr. Chairman, I would be pleased to respond to any questions either now or after Comptroller Ludwig's testimony, as you wish.

[The prepared statement of Mr. Newman can be found in the appendix.]

Chairman NEAL. Thank you, Secretary Newman, very much. If it is all right, we will go ahead and hear from the Comptroller, then we will be able to ask both of you some questions. So, Mr. Ludwig, we look forward to hearing from you.

STATEMENT OF HON. EUGENE A. LUDWIG, COMPTROLLER OF THE CURRENCY

Mr. LUDWIG. Thank you, Mr. Chairman and members of the subcommittee. I appreciate this opportunity to testify on interstate branching. It is a pleasure to be before this subcommittee that has spent such a great deal of time addressing with great seriousness these important issues.

I have a detailed written statement. In the interest of time, I would like to submit that written statement for the record and will discuss briefly a few important points this afternoon. I will first review interstate banking in general, then discuss interstate branching in particular. Finally, I would like to address some issues that have been voiced concerning consumer protections.

I applaud the members of this subcommittee for your perseverance in addressing interstate banking which most certainly must be one of the issues in modern American banking with the greatest longevity. Over the decades the issue has prompted real concerns, concerns that were genuine regardless of whether, in hindsight, they were justified in fact. The concerns raised by interstate banking, the availability of credit, the safety and soundness of the banking system, the concentration of the industry, lay at the heart of public policymaking. People of goodwill could take opposing sides in this debate and did.

The structure of our banking system is a meaningful public policy issue because that banking structure directly or indirectly touches the lives of all Americans. Today the preponderance of evidence strongly points toward the public benefits that arise from interstate banking, particularly in the area of safety and soundness. The evidence is not just theoretical.

As my written statement makes clear, interstate banking is, in essence, a reality. Every State in the country has acted to permit entry by out-of-State banking companies in one form or another, and those actions are yielding real benefits for banks and the banking public. Even Hawaii, which Under Secretary Newman mentioned, permits acquisitions in some isolated instances.

Interstate banking permits banking institutions to diversify their asset portfolios and their sources of income more fully, thus reducing the impact of an economic shock in any particular region and providing a greater margin of safety to the bank and its depositors, as well as the deposit insurer.

Although, the evidence for consumer benefits from interstate banking is not as extensive as it is for safety and soundness, it is clear that the potential for important consumer benefit also exists. Where State law has made it possible, interstate banking has benefited consumers by increasing competition and expanding the array of financial services. Moreover, in the high-technology, fast-moving age in which we find ourselves, there is an obvious advantage to many consumers, both individuals and businesses, in having their banks able to offer full banking services across State lines and indeed across the continent. Many of us who live in metropolitan areas are only too aware of the inconvenience we face when we cannot bank efficiently where we work because our home is 10 minutes away across a State line, and we have our primary banking relationship there.

In discussing lines of business for banks, I have often stated my belief that for any new banking activity to be permitted, it must pass a two-part test. One, it should not cause material safety and soundness problems; and two, it should, on balance, benefit consumers of financial services, large and small, businesses as well as individuals. Interstate banking would pass both parts of this test.

For the most part, banking firms with interstate operations are today required to do business through separately chartered subsidiary banks in each State in which they operate. This arrangement drives up the cost of banking operations and therefore banking services. It inconveniences consumers. Yesterday Secretary Bentsen suggested that we change the law to permit interstate banking organizations to convert from multibank systems into a multiple branch system, a system which could then grow by acquisition and conversion and de novo branching where State law permits on a going-forward basis.

In short, the administration supports interstate banking and branch consolidation along the following lines, as also reflected in Secretary Newman's testimony: One, any bank or bank holding company would be permitted to acquire a bank or bank holding company in another State; two, once the out-of-State bank had acquired a bank in a host State, it could convert the acquiree to a branch; three, having completed the acquisition and consolidation, the out-of-State bank could branch anywhere within the acquiree's State to the extent intrastate branching is permitted by State law; and, finally, States that do not want such out-of-State acquisitions or branching by out-of-State entities could opt out.

In effect, the administration supports creating a Federal legal structure for nationwide banking that would allow States to opt out. Beyond this, the administration has not worked out the details of a full legislative proposal in this area. At present, the administration has other legislative priorities, including its Community Development Financial Institutions bill and RTC recapitalization legislation. However, I can say that the administration will be working on the details of interstate consolidation legislation in the weeks and months ahead. In this regard, I want to make special note of our willingness to discuss with public policy groups any ideas they may have about how such legislation may best benefit the public.

In short, permitting banks to operate interstate branching networks would allow them to provide more convenient and cost-effective service to their customers without impairing safety and soundness. Consolidation of multibank holding companies into branches would eliminate the need for multiple charters, boards of directors, and administrative structures, facilitate the consolidation of back office-operations, and allow banks to achieve greater economies in advertising and in marketing.

Consolidation would also reduce the burden of complying with government regulation by decreasing the number of regulatory reports that the bank must file and the number of requests for information that it receives from its supervisor. For example, each quarter every bank submits a report of condition and income—the call report. Those reports are approximately 30 pages long and include about 600 items for banks with more than $100 million in assets

and about 400 items for smaller banks. Thus, a multibank holding company with 10 separate affiliates must submit 10 reports each quarter. If a multibank holding company can consolidate its banks into a single bank, it would have to provide only one set of information, not multiple sets.

Savings such as these would complement current efforts by the OCC to reduce unnecessary regulatory burden. Further, lowering costs through interstate branching would, in fact, add to bank safety and soundness. To the extent that banks realize cost savings, they will be able to augment capital, directly strengthening the bottom line of both individual institutions and the industry as a whole, and thus directly improving safety and soundness.

Consolidation of operations into branches would not add to the risks of banking in any way. Regardless of corporate form, our fundamental task will remain the same: Assessing the condition of each bank and the risks associated with its current and planned activities; determining if risk management systems exist and if they are properly designed; communicating with senior bank management about deficiencies; and validating the correction of those deficiencies. If anything, consolidation should permit the supervisory agencies to focus more sharply on the risks to the organization as a whole, to conduct a more efficient review of overall asset quality, and to provide a more accurate picture of the condition of the institution.

While interstate branching poses certain challenges in the areas of community reinvestment and consumer protection, I am confident that we can meet these challenges successfully. We can meet them through either statutory or administrative action. For example, the Community Reinvestment Act regulations require banks to address the credit needs of their delineated communities. As banking firms consolidate their operations into one bank, we will have to find ways to ensure that a bank with branches in widely separated areas helps meet the credit needs of all the communities it serves. We already have much experience in this area in States such as California where banks have wide-ranging networks of offices.

I am confident we can work through these complications, and I am confident that we can work through any other CRA complications that interstate branching may bring about, in large part because of the President's personal concern with CRA and because of my commitment to CRA reform. At the end of our ongoing reform process, we will have a CRA compliance system that will work with any corporate form of interstate banking.

At the same time, we are well aware that interstate branching will require us to work through a number of complex issues regarding State and Federal consumer protection statutes and consumer concerns about the potential for excessive concentration in the banking industry. Guided by the principles that consumer protection is the paramount concern, I am confident we will work through those issues.

In conclusion, interstate consolidation would be an important change in the way that banks are permitted to organize themselves. It would permit banks to serve their customers better and at lower cost. It would result in significant cost savings for banks

which in turn would strengthen institutions and assist them as a whole, thus enhancing, as I have said before, the safety and soundness of the individual institution and the system.

I want to thank you, Mr. Chairman, and the members of this subcommittee for this opportunity to testify on interstate banking and branching. I look forward to answering your questions.

[The prepared statement of Mr. Ludwig can be found in the appendix.]

Chairman NEAL. Thank you, sir, very much. Thank both of you. As I listened to your testimony and I know as we comment from time to time up here, I know that this must sound to some like just a very dry, arcane sort of subject with no real interest for the average person, but frankly, I think that this issue and the reform that we are suggesting here has enormous benefits for really every person in this country.

As you all have said and we have said many times, it enhances the safety and soundness of the system, so it reduces the likelihood that taxpayers will ever have to bail out the system which ultimately taxpayers stand behind. It improves opportunities for consumers of banking services. It improves convenience. It offers promise of lower cost for banking services for everyone.

I know most people objected to the idea that we are so overburdened with bureaucracy and paperwork. As you pointed out, Mr. Ludwig, it dramatically reduces bureaucracy and paperwork. It strengthens supervision and regulation because it allows the regulators to focus their attention more narrowly so they don't have to be spread as thin. It dramatically improves the safety and soundness of the system.

I am repeating myself again, but when I think of that and the cost savings to the system, we are really talking at a minimum about hundreds of millions of dollars of cost savings to the system, so this is no minor thing. Some people have said that it is probably the single most important banking legislation that we could pass at this day and time.

Now, I agree with you that we need to give priority to the RTC. We have done that, as one of you pointed out. It has passed the House; it passed the Senate. We are working in a conference now, and I think we are close to something that will satisfy all concerned. I don't disagree. I think the consumer banking legislation is fine, but compared to this it is very minor. I mean, you are actually talking about a bill there that will provide a little more than $1 million per State, and the potential savings here to the system are literally hundreds of millions of dollars, so I just want to make it clear.

I think this is major legislation. It is not a little thing; it is important legislation. We ought to go ahead with it. Now, one of you mentioned you hadn't had a chance to craft actual legislation. May I respectfully suggest you take a look at the Vento bill because we worked on this now for years, and I think the Vento bill, it started out as the amendment, as Mr. Vento point out, that passed the House. It was a compromise that we worked out.

I think it does everything that you want to do. If I am mistaken, well, certainly, please let's talk about it, but I believe honestly it does what you want to do. My point there is I don't believe there

needs be any delay because of drafting problems. I mean, I think you have got it there.

Now, as I understand, I just really have one question for you. I believe the only thing I hear that you have in mind that may be a little different from the Vento bill, and I am just not clear on this point, is that you might not allow a de novo branching into a new State. Is that true, and if it is true, is that the only difference between what we have been talking about and I refer to as the Vento bill, and if it is, why? What would be the reason for not?

Mr. NEWMAN. Well, Mr. Chairman, that is correct, that we have not addressed that issue, and——

Chairman NEAL. But other than that, now we are really talking about complete interstate branching, either consolidating the branching that has already taken place, allowing the branching organization if a bank acquires a bank in another State. So the only other possible situation we could be talking about would be de novo branching into a new State, I believe, is that not correct?

Mr. NEWMAN. I think logically that is correct, Mr. Chairman. We just haven't addressed all the issues with respect to States' rights and consumer protection or anything else that might be involved in that and want to make sure, as Secretary Bentsen mentioned, that we take a deliberate and disciplined approach. But many of the items that you have spoken of we very much support.

It is hard for us to speak specifically as to whether every item in a particular bill is one that we are comfortable with because, as we both mentioned, we have outlined some major principles but haven't gone through every single provision of the various bills.

Chairman NEAL. Well, please take a look at that one because I think it does everything you are talking about. It allows for the States to opt out if they want. I don't think any States will opt out because all of them, except for a couple, I guess, allow interstate banking now anyway. But if they want to they could do it under the approach that we are talking about.

I just want to—may I just make this point? It really would offer a competitive advantage to the already established banks if you were not to allow the de novo banking. That is the way the Bentsen statement first read. I am sure you don't want that. That is not—that would just lock in a competitive advantage which there is no reason for. We want to encourage more competition, not restrict it.

And I think that you could apply that same idea to the idea of branching anew into a new State. All it does is offer more competition, more benefits, it seems to me.

Yes, sir?

Mr. LUDWIG. Just to be clear, we are not locked into a one-time consolidation here. The Secretary's speech, read fairly, says that, on a going-forward basis, were you to acquire a bank in a new State, you could consolidate that bank as a branch of your existing bank in your home State. It wouldn't be a one-time event.

Mr. NEWMAN. Mr. Chairman, one other comment about the pace of things here because, in all frankness, I think the essence of it is that you are ahead of us.

We are trying to be careful about a number of these issues, as both Gene and I mentioned and Secretary Bentsen mentioned. As

a matter of fact, he specifically said we would like to listen seriously to the concerns of all those who have a genuine public policy interest in an issue, and have the opportunity to discuss those issues through before taking a position on each and every provision.

We are really not trying to drag our feet, and we would be very happy to work with you on those issues.

Chairman NEAL. Great. I look forward to that.

I guess the only reason we would be ahead is we worked on this for so long. As someone pointed out, this approach has been endorsed by every administration going back to the Carter administration, I believe. It is almost like the situation with the RTC legislation. Every day that we delay is costing the system lots of money. It is creating more inconveniences for consumers. It is reducing the safety and soundness of the system and so on, so I mean it is a costly delay. There is just no reason.

It is not your fault. I am not—please, don't misunderstand me. I am delighted that you all are moving ahead with this. But actually, in fact, the delays have been brought about by political problems that occurred in the Congress. No problem of yours. I commend you for taking these steps, but I just urge you please go ahead and talk to whoever it is you think you need to hear from and let's go ahead with it because it is very costly not to. So, anyway, I thank you.

My time has expired. I yield to Mr. McCollum.

Mr. MCCOLLUM. Thank you very much, Mr. Chairman.

I just want to clarify a couple of things so I understand where we all are on this at this point and where you are particularly at the administration.

Am I correct in understanding that there is no opposition—there is just simply no opposition relative to the idea of pure interstate banking, where somebody who owns a bank in State X decides they want to go and open a branch of that bank in State Y rather than buying a bank, in other words starting a new bank or the de novo. You are not opposed to it? You just don't have a position, is that what we understand here today?

Mr. NEWMAN. I guess that is a fair way of saying it, Congressman. We do have a set of principles which include, as we mentioned, a concern about the protection for the consumer, the concern about respect for States' rights and believe that straight consolidation is just an easier format to look at to be very comfortable that a number of these concerns can be dealt with easily. And we believe that that addresses the majority of the issues that need to be addressed and so focused our attention in that direction.

Mr. MCCOLLUM. Well, what I was getting at, too, if Chairman Neal and I and the committee—the subcommittee—first decided to mark up a full Interstate Banking bill this coming month in November before we went out on the recess and it included an opt-out provision and essentially allowed the de novo type of branching, would you oppose our doing that?

Mr. Ludwig.

Mr. LUDWIG. I am not sure that we would oppose it, but I must say that I don't think we are in a position today to give you an assurance that we would not. Where the administration is on interstate banking is that, as I stated, we would favor the acquisition

of a bank in any State, with an opt out. But we haven't addressed de novo branching nationwide, and I don't think either Secretary Newman or I know where the administration would come down on that issue.

Mr. McCOLLUM. I think that is a clarification that I wanted to receive from you. I just can comment, as I did in the opening statement, that I am happier with that position than opposition to it, but I think you are being—or the administration is being—overly timid and overly cautious in this area because I think there is a lot of support for that.

And if you wish to achieve it, which I hope that you do, I just want to assure you that if you don't trap it with insurance provisions and other things that it is something that can pass. It did pass both the House and the Senate in 1991.

Let me change the subject very briefly with you.

Mr. Newman, 3 weeks ago you appeared before us and addressed the issue of director and officer liability in response to questions from Mr. Schumer and Mr. Bereuter. You mentioned that it is becoming increasingly difficult to attract good outside directors, and you stated that the directors should be held to the same standard as directors in a nonbanking corporation. At this point, is there anything that you or the administration is doing to try to alleviate the problem and to set that kind of a standard or to propose legislation to us or anything of that nature?

Mr. NEWMAN. Well, I can't think of any specific legislation that we are working on at the moment other than to note that, interestingly enough, interstate consolidation would eliminate the need for lots of directors.

Mr. McCOLLUM. It would reduce the number, that is for sure.

Mr. NEWMAN. It really is a practical problem to find enough qualified people who are willing to undertake the risk to be directors and that would have some influence.

Gene, do you have anything to add?

Mr. LUDWIG. I think that concentrating on those boards of directors that really control the institution is a healthy thing. Each director of a consolidated institution will have a terrific responsibility but will be the focal point of that responsibility. Taking time to select the best directors will be a very meaningful exercise. If you have 30 or 40 banks and you have 30 or 40 boards of directors, you are spending an awful lot of time with folks who really are not central to the true decisionmaking issue.

Mr. McCOLLUM. Within the very few coming days I am going to be introducing a proposal in this regard. I don't know if Chairman Neal will be joining me or not. He currently has it down in his shop considering it, but I would hope that you would look at it and comment on it. And maybe out of it, whether it is that product or something else, we could come up with some legislation. Because that is an another area that I know members of the subcommittee are very anxious to try to address in some fashion.

Mr. LUDWIG. I would add that the FDIC Board of Directors is working hard to achieve some level of consistency and predictability in terms of liability for directors. We are aware of this problem, and I personally am quite committed to achieving some level

of consistency and predictability for directors because it is a serious burden.

Mr. McCOLLUM. Thank you very much, Mr. Chairman. My time has expired.

Chairman NEAL. Mr. Klein, then Mrs. Maloney.

Mr. KLEIN. I also would like a little bit of clarification.

If I understand correctly, under the proposal of the administration if a bank in State X wants to acquire a 200 branch bank in State Y, having made the acquisition, assuming that State Y didn't opt out, the bank could—the acquiring bank could then have unlimited branching authority in State Y, am I correct?

Mr. LUDWIG. If that is the rule within that State.

Mr. KLEIN. Assuming that is the rule within that State?

Mr. LUDWIG. Yes.

Mr. KLEIN. Now, if the bank in State X then acquires a single branch bank, finds a little bank, a $1 million asset bank in that same State, it would also have that unlimited authority, would it not?

Mr. LUDWIG. That is correct.

Mr. KLEIN. Well, what is the difference between that and the de novo branch? I mean, I understand the legal difference, but I don't understand the practical difference.

Mr. LUDWIG. I think your question is a good one. One can certainly pose a case where a banking firm acquires a small bank in State Y and where it basically develops its own de novo branches throughout the State.

However, the one thing we are not suggesting here is a sham operation in which the bank in State Y is developed yesterday and acquired the next day. We are pointing toward real acquisitions.

Mr. KLEIN. No, I understand that, Mr. Ludwig, and I am not suggesting a sham acquisition. I am simply suggesting an acquisition of a long existing bank but a very, very small one, a single-office bank.

I understand the policy reasons for saying that States' rights would call for an opportunity for each State to opt out. I don't understand the policy distinctions, though, between de novo branching and acquisitions of small banks. And if you say, well, we are not going to let you acquire a small bank, where do you draw the line? I just don't understand the policy reasons.

Mr. LUDWIG. In large part it is a States' rights issue. Where the State itself permitted an out-of-State institution to branch within its State by way of de novo branching, we would permit that. That would be a State decision. A State could also decide to allow banks to acquire an entity in their State and set up a branch. That scenario would also be acceptable to the administration.

Mr. KLEIN. The other question I wanted to get into, and I alluded to it in my opening comment, how do you see interstate branching as impacting on the ability of banks to deliver credit, particularly credit that would fuel economic growth?

We all talk about a credit crunch, and we have heard arguments both ways as to why it is happening and what is causing it, but do you see interstate branching as having any impact one way or the other on the availability of credit and the alleviation of the credit crunch?

Mr. LUDWIG. We believe there are significant efficiencies which will get translated into benefits to consumers in a variety of ways. One way is an ability to concentrate resources on business. Banks, in large part, are in the business of extending credit. So we would expect this would have a benefit. That is one of the reasons that the administration supports it.

Mr. KLEIN. By the same token, however, I hear a lot from businessmen that when there is a major acquisition that they suddenly find that the friendly people that they used to do business with have moved to some other parts unknown, and they find it very, very difficult to do business with the huge acquiring institution that now is their bank.

Mr. NEWMAN. I am sure, Congressman, that there are instances of that that are really not very good. On the other hand, there may be lots of reasons for it. Sometimes the old friendly banker was maybe a little too friendly, and one of the reasons his bank got acquired is because they were putting on a lot of loans that they really shouldn't have put on in the first place, so somebody has now come in to exercise a little bit more discipline, and that is just one of the results.

Clearly, the banks who are most successful in this process are those who have learned how to use their centralized policies but have local decisionmaking within those policies by the local people they have in place who get into the community and get to know the community and the people in the community, and those who have not done that so well haven't been so successful. It is sort of an ongoing learning process.

Another thing which might be helpful in this regard, both Gene and I referred to the ability to bring funds into an area that might otherwise be a very troubled State or region. And that is possible to do now with the clumsy structure that we have. But it is clumsy, and it does require sometimes literally two bank subsidiaries of a holding company agreeing on a legal document to share a credit—to provide a credit to a business in one State. Whereas, if we had the interstate branching, that wouldn't be a problem at all. You could just fund that business loan directly without all of this overhead.

Mr. KLEIN. Thank you very, very much.

I see my time has expired.

Chairman NEAL. Thank you, sir.

Mr. Baker.

Mr. BAKER. Thank you, Mr. Chairman. I have just, as usual, a statement, then one question.

I think the effort to move some interstate legislation, however it is finally put together, is an admirable step, but I really have to say that we are missing a huge part of the needed solution to our problem in the current environment. In the last 40, 50 years bank assets have gone down by 50 percent.

In the last decade nonbank entities assets have tripled. The stock market is full of money running from institutions that are regulated and safe and sound and fully insured to pension funds and mutual funds that are completely 100 percent risk taking, although the rate of return is significantly higher.

If we are going to provide a mechanism in which financial institutions which are regulated are to survive, we can't just continue to increase the cost of doing business with enhanced consumer requirements, with enhanced lending requirements, with higher capital standards, with more frequent audits, and scratch our heads as to why bottom line profits may be in jeopardy in some markets when we say on the one hand you can't sell your product but in a certain geographic region, which is part of the problem, but, second, you also limit severely the product line, and we continue to fight within the financial institution marketplace over issues such as the comptroller's loophole and other powers questions.

Some on this subcommittee even want to take existing powers away from banks and roll back the current authorized ability to sell products which generate bottom line profit, at the same time promoting higher cost regulatory standards for those same financial institutions.

We are on a direct beeline for another significant problem if interest rates—and I guess I won't be too much of a pessimist to say there are ups in the business cycles, and there are downs. The only certainty is if you are on an a up there will be a down, and if you are in a down there will be an up.

We seem to be making money right now, and I hope it lasts for a long time. If we are heading for a down and we are heightening costs to do business and we are not allowing new products and we don't allow geographic diversity, we are—we will be one day in a very deep problem from which there is not an ability to extricate ourselves. We need a plan, and I just hope that we can move forward.

And let me say in deference to the Chairman, the RTC business, I think as a member of the Conference Committee, probably worked out, but—if we accept the House position—but it may be worked out. If we don't, it is probably dead. But, either way, it is worked out.

I think we have got to move forward. We have got to stake out our territory, and we have got to put rational thought into our financial market services industry because the world is changing anyway. Will we have more than just a battle over interstate, will there be other elements to your reforms that we can look forward to in the coming weeks?

Mr. LUDWIG. Absolutely. In a deliberate and careful fashion, as the Secretary indicated in his speech, we will be addressing the financial services industry and, in particular, the banking industry in terms of products and services. As you know, Congressman Baker, we have been working very hard at relieving burden, and that is an ongoing process. You will see over the next several weeks a variety of new steps in that area.

Mr. NEWMAN. I will just add to that, Congressman. I understand that both you and Congressman LaFalce have raised this issue, sort of a bigger vision. And, as Gene just said, we are looking at a number of issues over time but are trying to take the deliberate process that Secretary Bentsen outlined. And I realize you could debate that either way about having a bigger vision and then addressing the pieces within it.

Mr. BAKER. If I may, before my time expires here, I am just going to say that, regardless of what your initial interstate proposal may look like, before it gets through this process a lot of those other issues will be debated anyway. It goes even to the question of administrative regulatory reform. How many supervisors does an institution need to be safe? How much in the way of fees do you really need to be paying in order to make sure that you are paying for adequate supervision, parity among premiums? If we don't deal with that issue we may put an end to one portion of the industry anyway.

I just—time is of the essence. And while we have got banks making money and they are still alive, we need to get the system in good shape.

Mr. NEWMAN. We do share that concern. And I think we both noted in various forums that the banking industry is very healthy right now, but we need to make sure that the scenario is set for it to be healthy into the next century, which means addressing some of these issues, these more secular issues that you were just referring to, and we do share that concern.

Chairman NEAL. I want to say I also think that is very good news that you are thinking along these lines because banks are healthy now largely because interest rates have come down dramatically. We can't do that all over again. That is sort of a onetime trick. And there is a lot of support on this subcommittee and within the Congress, I think, for modernizing our financial system.

And I agree with Mr. Baker. I just hope we go ahead with it sooner rather than later. We have been also working on that for many years, and we are ready to work with you and hope that we can work together soon on these issues.

Mr. LUDWIG. We are looking forward to working with you, Mr. Chairman. As Frank said, we realize that time is of the essence here. These are very serious issues that we have to take up with some speed.

Chairman NEAL. I want to recognize Mrs. Maloney, but may I just say before that I have a meeting with the Speaker, and Mr. LaFalce has agreed to take over the subcommittee for me and probably close it down. Before leaving, I just want to thank both of you again for coming. I look forward to working with you on this and other issues.

Mr. NEWMAN. Thank you, Mr. Chairman.

Mr. LUDWIG. Thank you, Mr. Chairman.

Chairman NEAL. Mrs. Maloney, I would like to recognize you and thank you again for your leadership on this issue.

Mrs. MALONEY. Yesterday, in the Secretary's speech he said that the basic approach, and I quote, would be to let banking organizations convert existing multibank, multi-State operations into a single bank, multibranch operation. Yet, today you are not talking about existing multibank, you are talking about permanent consolidation. Would you clarify between that?

Mr. NEWMAN. We can see the reason for the ambiguity there. The word "existing" was not intended to be taken out of context. In the total outline of the approach that the Secretary was discussing, we didn't intend for that word to be taken so literally. What we really meant was what existed at the time rather than what ex-

ists necessarily today. So it would envision a future acquisition in a given State then being eligible for consolidation.

Mrs. MALONEY. OK. I would hope that you would likewise look at H.R. 3129 that I introduced, and I would like your comments on it, and it is similar to S. 743 which has passed the Senate several times and has the advantage of having had Secretary Bentsen vote for it which encompasses the four principles that you outlined today.

May I ask why did you decide to really sort of switch to an incremental approach on approaching the banking problems?

Mr. LUDWIG. Do you mean banking problems beyond interstate issues?

Mrs. MALONEY. Yes.

Mr. LUDWIG. We are really serious about the two-part test that I articulated in my testimony. As a new administration, we want to look at these issues with a great deal of care because of their impact on consumers, banks, and other entities. We are trying to move along as quickly as we can, but we really do want to give these issues a fresh and serious look from a safety and soundness perspective and from a consumer perspective, which we are doing. But this is something we must move along on.

Mrs. MALONEY. Thank you very much. I look forward to your comments on H.R. 3129. Thank you.

Mr. LAFALCE [presiding]. Thank you very much.

Mr. Newman and Mr. Ludwig, unfortunately, I had to be absent for about a half hour, and I understand that there has been some crystallization of the issues and further refinements of the Secretary's speech of yesterday. Could you encapsulize for me what those refinements have been? What is settled administration position and what issues have been raised by the other members that you still consider open in the eyes of the administration?

Mr. NEWMAN. That is a comprehensive question, Mr. Chairman. Let's see if between us we can hit some of these things.

We did just clarify the issue that Congresswoman Maloney was asking about in terms of future acquisitions being eligible. We talked about and clarified the issue of a State being able to opt out.

Mr. LAFALCE. So you said yes for that?

Mr. NEWMAN. Yes. And that we also noted that it probably would not be appropriate for a State that did choose to opt out of this program to have banking companies headquartered in its State to then participate in this program. It is sort of in or out.

Let's see. We talked about the difficulty of getting meaningful market share limitations and our belief that the existing concentration and competitive analysis mechanisms that are applied by the regulators and by the Justice Department address the issues in a better way than a mechanical formula could address them, and actually addresses them market by market rather than an entire State, and——

Mr. LAFALCE. What are those existing Justice Department guidelines?

Mr. NEWMAN. Well, they are not prescribed guidelines. They are more approaches that are taken, for example, by the OCC, by the Federal Reserve, and by the Justice Department.

Mr. LAFALCE. So are these antitrust approaches?

Mr. NEWMAN. Yes, yes.

Mr. LAFALCE. Are they really antitrust approaches?

What antitrust law would be applicable if there is a law or are these regulations that you have?

Mr. LUDWIG. Every time we approve an acquisition——

Mr. LAFALCE. This, of course, is not an idle question because I remember from when I was advancing interstate legislation in 1985 and 1986, in fact, I got it reported out of the Banking Committee in 1986. The market share issue was a hotly contested one. Individuals were advancing amendments, Mr. Vento and others were advancing amendments that would say, not if you have a certain percentage of the assets in a specific area, not if you have a certain percentage of the deposits in a specific area. And it was a very quantifiable approach, which I had a lot of problems with because our universe was so small. We were looking exclusively at depository institutions rather than looking at the total universe of financial services firms that we were engaged in competition with.

You are suggesting that there must be something to deal with the issue of concentration. I am just trying to figure out what it is now and what it is that it might be in the future.

Mr. NEWMAN. Fair enough. Let me respond from the perspective of somebody who was a banker up until last year and maybe Gene could respond from the OCC's perspective.

But this is something that is done very, very seriously. And I can tell you from my own experience, having gone through it from the other side, from the point of view of an applicant bank that was applying to the regulatory agencies and going through the Justice Department review, it was extremely thorough and looked at a number of these issues that you just mentioned. So it recognized that the common measures of market share may not be appropriate, and that you have to look inside the nature of the deposits in any given branch. You had to look and see what other kinds of institutions were offering opportunities for savers in that community.

Mr. LAFALCE. Is there some specific document which articulates the factors that are considered?

Mr. LUDWIG. Yes, we can provide you, Mr. Chairman, with the factors that we consider.

Mr. LAFALCE. Are these something where, if I wanted to go interstate right now, I would say, give me the document that contains the factors? Or is this something you would have to come up with?

Mr. LUDWIG. No, we have got it.

Mr. LAFALCE. Let me just pursue the document a bit more. Is this document a piece of paper that can change from day to day or is this document subject to some regulation that has been promulgated?

Mr. LUDWIG. Antitrust analysis does develop over time, and there is a sense that it is something of an art.

Mr. LAFALCE. But is this artistry codified in any way?

Mr. LUDWIG. Absolutely.

Mr. LAFALCE. So if a financial institution wants, is there some document that they could get and say, if I match up against this I am OK? If I don't match up against this I am not OK?

Mr. LUDWIG. There is the Herfindahl-Hirschman index concentration and——

Mr. LAFALCE. Herfindahl Index Analysis. Now, what is that? I don't know how to spell it.

Mr. LUDWIG. The index answers the question of the degree which there is going to be market concentration. Determining that is complex for the regulatory agencies and for the Justice Department. A great deal of time and effort has been spent developing the methods as well as applying the various market tests. It is something that is not entirely a science where you can basically count up everything and know exactly what is going to happen. At the same time, we do have detailed written procedures that deal with this issue.

Mr. NEWMAN. Again, from the point of view of an applicant, let me add that even though——

Mr. LAFALCE. From the point of view of an applicant, the more precision I can get from you, the better the applicant would like it.

Mr. NEWMAN. Exactly, Mr. Chairman. But, unfortunately or fortunately, depending on how you look at it, the real world doesn't operate that way, even though there are these Herfindahl indices that Comptroller Ludwig referred to.

Mr. LAFALCE. That neither of you wants to spell out for me.

Mr. NEWMAN. Please, don't put us to that test, Mr. Chairman.

But, again, in actual experience the regulatory authorities and the Justice Department will look at any issue that they think is relevant in any particular market. They may take a look and say, aha, in this particular market we have a concern about small business loans. In this market we have a concern about consumer loans.

They will look not only at banks but all the other providers since we know in today's marketplace there are many, many other kinds of institutions that provide lending. They will look at that whole set of array of providers of services and try to determine whether there is sufficient competition in any given market area.

In addition to that, the State authorities look. So the State attorney general in many States will have its own antitrust guidelines and its own look on top of the Federal authorities.

Mr. LAFALCE. All right, good.

Would you go back to the question that I stopped you from answering and crystallize what is decided and then also articulate what is still open?

Mr. LUDWIG. Mr. Chairman, you can articulate the administration's views on interstate banking in terms of the four principles which we outlined when you were out of the room. Any bank or bank holding company would be permitted to acquire a bank or bank holding company in any other State. Once the out-of-State bank had acquired a bank in a host State, it could convert the acquiree to a branch—at any time in the future. Having completed the acquisition and consolidation, the out-of-State bank could branch anywhere within the acquiree State to the extent intrastate branching is permitted by State law. And, finally, the States that do not want such out-of-State acquisition or branching by the out-of-State entities could opt out.

Mr. LAFALCE. Then what does that leave open?

Mr. LUDWIG. It leaves open a variety of technical questions, for example, the one Congressman Klein alluded to on how long the acquiree bank has to have to been in existence. What is the test you need to avoid a sham acquisition where someone had the bank created on "day one" and then acquired it on "day two"? It is that level of detail.

Mr. LAFALCE. What about de novo?

Mr. LUDWIG. We would not, at this stage, propose de novo branching in a second State except in cases where the second State itself permitted out-of-State entities to enter through de novo branching.

Mr. NEWMAN. We also——

Mr. LAFALCE. But that is an open question. You are not proposing it, but you are not opposing it, either. Or are you opposing it?

Mr. LUDWIG. At this time, we haven't taken a firm position on it. If it went forward, one would have to worry about whether the administration might well oppose it and veto the bill. At this point, we have sort of articulated where the administration is. We are comfortable with where we are.

Mr. LAFALCE. You are leaning, no? OK. This would almost sound to me as if there might be a room filled with individuals from Arkansas and California. I remember so many pieces of legislation we had to consider in Congress to deal with the archaic provisions of law and constitution in Arkansas, for example.

I remember in the 1970's when there was a provision in the Arkansas State constitution to establish a usury ceiling, and we had to attempt to pass Federal legislation preempting that because there was an unbelievable credit crunch within the State of Arkansas. You couldn't get credit if banks could only charge an interest rate considerably lower than the cost of money for the financial institutions.

My concern is whether your inability to go further than you have on interstate—that is, to endorse de novo branching—is a reflection of your overall approach to financial services modernization. Not only are you behind where we are now, you are behind where we were 10 years ago. Let's not kid ourselves about that. Is it because of some inhibitions you may have because of prevailing sentiment encouraged by individuals who think the way individuals from Arkansas thought?

Mr. NEWMAN. Well, let me try a couple of thoughts, Mr. Chairman.

First of all——

Mr. LAFALCE. If you can figure out my question, you are pretty good.

Mr. NEWMAN. It is our belief that the consolidation approach that we have been discussing addresses the vast majority of the issues that are really fundamental here. We just don't see a great demand in the industry, a great need in the industry, for opening de novo branches in multiple States. But we do see a lot of operations that—there are already 40 States or maybe slightly more than 40 States in the Union that have banks headquartered or bank holding companies headquartered in those States that operate in multiple States. And that is a real need. Addressing the consolidation

is a real issue. And we put our attention on that real need where there is customer inconvenience.

Mr. LAFALCE. I accept that thinking. I am more concerned that this type of thought process might extend itself to other modernization issues where there is a greater need than there is for de novo branching.

Mr. NEWMAN. Fair enough.

Mr. LAFALCE. That is what I am concerned about. So if there have been any political concessions on this issue, well, maybe so be it, maybe, but be careful that we don't give away the store. If you want reform and modernization, it ought to be substantively that.

Let me turn my attention to another area, and that is CRA. This is very important, I think. What is the status of your reform efforts on CRA? Are we going to convert it from a Paperwork Compliance Act into a real Community Reinvestment Act where we are more concerned about doing what is doable than coming up with some papers that can either please or displease people?

Mr. LUDWIG. Mr. Chairman, I am pleased to answer that question. The President really——

Mr. LAFALCE. Of course, this is essential—this should be done at least contemporaneously with interstate it would seem to me.

Mr. LUDWIG. It is very important because interstate banking must not lead to a situation where individual communities, particularly low- and moderate-income communities, are disadvantaged because of a new corporate form. I am pleased to say that the President gave very strong direction in his letter to the regulators directing us to eliminate process and to focus on lending, services, and investment. As you know, we have held hearings all around the country. We have heard from 250 witnesses. We have thousands of pages of testimony. I am fairly sure that we will have those translated into a regulation that will be published for comment in November. We certainly will meet the President's deadline of January 1. And that regulation, I am confident, will focus on performance and objectivity; it will not focus on process. We have worked very hard at that. The President set a strong direction, and we will be able to comply with his direction.

Mr. LAFALCE. Gentlemen, thank you very, very much for your testimony today. I am sorry I couldn't have been here for all of it, but I was here for all of it that I could be here for. Thank you very, very much.

Mr. NEWMAN. Thank you.

Mr. LUDWIG. Thank you.

Mr. LAFALCE. The hearing is adjourned.

[Whereupon, at 4:15 p.m., the hearing was adjourned.]

A P P E N D I X

October 26, 1993

STATEMENT OF THE HONORABLE STEPHEN L. NEAL AT HEARING ON INTERSTATE BRANCHING LEGISLATION

Tuesday, October 26, 1993

Let me welcome everyone to today's hearing, which I anticipate will be the Subcommittee's last on interstate banking and branching issues.

Today we will hear from Administration representatives.

After reviewing your written testimony, Mr. Newman and Mr. Ludwig, I can say I wholeheartedly agree with you about the benefits of liberalized branching laws:

- Interstate branching will allow consumers and businesses better access to banking services;

- Interstate branching will enable banks to cut costs, and use the savings to make more loans and improve their capital cushion;

- Interstate branching will permit banks to better insulate themselves from regional downturns, by allowing them to better diversify both their loan portfolios and their sources of deposits.

I also agree with you that some of the concerns about interstate branching have been greatly exaggerated:

- The durability of small banks in states that have long permitted full statewide branching amply demonstrate that community banks will survive and prosper in a world of interstate branching;

- Concentration concerns are often overstated, because concentration levels in locai banking markets have remain unchanged, while across the country mutual funds, securities firms, insurance companies, and other financial services providers increasingly compete with banks to attract deposits and make loans;

- Finally, there is no indication that interstate branching would accelerate the flow of funds in and out of communities that currently takes place via mutual funds, bank investment in securities, and sales of fed funds.

In short, the Administration has made a convincing case that interstate branching legislation is in the national interest.

But I am somewhat confused about the shape of the interstate branching proposal the Administration will support. In this and previous Congresses, a number of different interstate bills have been introduced, including consolidation measures by Congresswoman Maloney and by myself, and a broader proposal which Congressman Vento has authored and which I co-sponsor. I hope we can get down to specifics and clear up some of the confusion about the Administration's position in the course of today's hearing.

In addition, while I appreciate the Administration's effort to set priorities, I hope it will be flexible on timing, and will not insist that each priority for financial services legislation be enacted in the exact order Secretary Bentsen articulated yesterday.

I am not averse to community development banks, fair trade in financial services, or regulatory restructuring, but work in Congress on interstate branching may well be more advanced than it is in some of these other areas. We should not pass up golden opportunities to act in one area simply because efforts in others may be lagging.

That said, I am certainly delighted you both could join us here this afternoon. Inasmuch as we share a common belief in wisdom of liberalizing interstate branching laws, I look forward to working with you to craft a bill that achieves that objective, thereby reaping the many benefits you have so ably enumerated in your testimony.

Statement of Congressman Bruce F. Vento
Subcommittee on Financial Institutions
October 26, 1993

Mr. Chairman, I want to thank you for your continued attention to the issue of interstate banking and branching and for your efforts to move forward on this issue. Clearly, the time has come to modernize our banking system and passage of interstate is a crucial step.

I would like to welcome Under Secretary Newman and Comptroller Ludwig. I look forward to your testimony and to a clarification of the Administration's position on the future of our banking system. Frankly, some news reports of the Secretary's speech raise many questions. If the Administration's position is to more or less freeze in place the current status quo, such a configuration raises fundamental questions of fairness and the efficient function of our economy, consumers, banks and the federally insured Bank Insurance Fund. Permitting consolidation only in states where banks are already located restricts competition, denies consumers choice and will result in large regional monopolies. If Congress takes this half-step, which you have apparently advocated, full interstate banking and branching may never be realized, much less a rational banking system. Nor will this policy path provide a safe harbor for consumers, rather it would result in a distorted marketplace filled with pitfalls.

I am sympathetic to many of the goals which you have enunciated. I agree that the states must have a positive role in the process, not only in terms of permitting banks to branch but in setting appropriate, non-discriminatory requirements. Consumers and local communities have vital interests in this issue. Clearly, consumer rights must be protected and safeguards must be set in place to insure that interstate branched participate in the local community and not syphon away limited capital. Regulatory safeguards should be enacted to protect the insurance fund and, ultimately, the American taxpayer. These goals must be included in any proposal and I would point out that they are in the proposal authored by myself with Congressmen Neal and McCollum.

I hope that after today's dialogue, the Administration would further refine its views, including the time frame for action. Evolution and Darwinism should not be the model for interstate banking and branching. Today is the time for action. Interstate banks are healthy and can expand. We should not wait for a downturn in the economy and hold out interstate as a panacea to cure all the ills.

In 1991 I successfully crafted an initiative that has now been re-introduced and refined in 1993, H.R. 2235. The original Vento/Wylie amendment was overwhelmingly supported in 1991 on the House floor but was attached to a comprehensive measure that was not positively received.

Mr. Chairman, I believe that interstate banking should be on our agenda and working with the Administration we will be able to enact a comprehensive interstate bill next year.

STATEMENT OF

THE HONORABLE FRANK N. NEWMAN

UNDER SECRETARY OF THE TREASURY

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION,

REGULATION AND DEPOSIT INSURANCE

OF THE

HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

October 26, 1993

Chairman Neal, Mr. McCollum, and members of the subcommittee, I am pleased to discuss with you today the Administration's views on the geographic restrictions imposed on commercial banks in the United States. These restrictions are unique among the industrialized nations of the world, and many observers consider them among the least defensible of our banking laws.

The Administration supports the idea of relaxing these geographic restrictions, as Secretary Bentsen stated yesterday. In my testimony today I will explore some of the reasons for that conclusion, discuss the concerns most commonly raised with respect to geographic liberalization, and provide the

Administration's views on key issues with respect to interstate banking and branching.

I. Reasons to Relax Geographic Restrictions

Geographic restrictions on commercial banks originated in the earliest days of American banking. The purpose of these limits was to protect banks from competition and preserve local markets for local banks. However, these restrictions warrant reassessment because financial markets and institutions, and the economy itself, have evolved dramatically since then.

We no longer find the current framework of geographic restrictions appropriate, for several reasons. First, modern banks operate beyond local markets, and they compete with non-bank institutions that face no similar geographic restrictions. Second, the states themselves have relaxed geographic barriers. Third, removing these restrictions could improve the safety and soundness of the banking system. Fourth, the public could benefit from greater competition, improved bank performance, and greater customer convenience. Finally, removing geographic restrictions would give banks the flexibility to structure themselves more efficiently, which could permit banks to make more credit available for businesses and consumers.

Current Operating Realities

Banking organizations can no longer be defined in terms of the limited services and facilities that might have been appropriate in past generations. New realities are apparent on both sides of the banking balance sheet. For example, on the liability side of the balance sheet, banks fund themselves not only with traditional (local) retail deposits, but also with large negotiable certificates of deposit, foreign deposits, Eurodollar borrowings, Fed funds, repurchase agreements, and debt and equity issues, among others. These funding transactions can involve local, regional, national, and international financial markets.

On the asset side, large banks have for many years reached for business opportunities beyond local markets. Real estate loans, commercial loans, foreign government loans, securitized loans, and various types of loan participations typically require involvement in non-local markets. The same can be said of such other services as money management, cash management, electronic funds transfers, private placements, credit card distributions, foreign exchange dealing, and various risk management activities.

Further, geographic restrictions keyed to local markets have proven porous. Unlike brick-and-mortar branches, banks' loan production offices and Edge Corporations are not geographically

limited. In addition, banking organizations have routinely used subsidiaries to offer such financial services as mortgage finance, consumer finance, and securities brokerage across state boundaries. Moreover, numerous bank holding companies have used grandfather rights, emergency acquisitions, and evolving state laws to establish extensive, though unwieldy interstate banking networks.

Non-Bank Institutions. Many non-bank financial institutions offer products that compete directly with bank services. Yet these non-banks can operate more efficiently because they face no geographic restrictions. Mutual funds, many of which offer check-writing and other consumer conveniences, have become the most notable substitute for insured deposits. Securities firms also compete for the funds of savers by offering cash management accounts, with check-writing and credit card features, through large networks of geographically dispersed offices. Insurance companies provide a bank-like savings service nationwide through insurance policies with redeemable cash value; and they compete directly with banks in making large commercial and real estate loans. Other major competitors that operate free of geographic restrictions include consumer, business, and sales finance companies; mortgage companies; the captive finance firms of automobile and appliance manufacturers; and retail credit grantors.

On balance, geographic restrictions have outlived their usefulness and no longer reflect bank practice or competition. Rather, they require banks to organize themselves in cumbersome and inefficient ways to compete.

<u>The Trend Among the States</u>

The states already have come to recognize the inefficiencies of geographic restrictions. For example, as recently as 1980, over 50 percent of the states retained highly restrictive intrastate branching policies. Since 1980, however, branching rules have loosened considerably. Today, 46 states (plus the District of Columbia) permit statewide branching. Four states continue with limited branching, and no state retains unit banking -- the old policy of allowing a bank to have only one office.

Interstate banking has developed even more dramatically. From the time of the Bank Holding Company Act of 1956 to the mid-1980s, interstate banking barely existed, and then only through grandfathering or other limited exceptions. But once the Supreme Court upheld New England's regional interstate banking compact in 1985, the states rapidly implemented regional interstate banking. Currently, all states but Hawaii allow out-of-state bank holding companies to acquire banks within the state. However, these laws vary considerably from state to state. Consequently, we lack a

uniform, efficient, and truly national approach to interstate banking.

A number of factors help to explain the 1980s' trend toward easing geographic restrictions on banks. These include: (1) the desire of states to attract and pool capital that could be used to support a state's economic growth and development; (2) the need to facilitate the resolution of troubled banks and thrifts by permitting acquisitions by out-of-state institutions; and (3) the growing case presented to state legislators to establish competitive equity for banks vis-a-vis their non-bank competitors.

Safety and Soundness

Relaxing geographic restrictions will tend to promote safety and soundness in the banking system. Allowing banks to diversify their assets geographically promotes an aggregate income flow that is more stable than that from each area taken individually. The earnings of geographically limited commercial banks are more susceptible to the vagaries of local market cycles, which renders such banks more likely to fail. Indeed, a large number of the bank failures of the 1980s involved institutions which were overcome by regional economic weakness.

Moreover, a strong retail deposit base represents additional protection against failure and is furthered by geographic diversification. Historically, we have had instances where banks heavily dependent on purchased funds have experienced rapid deposit outflows, reducing their stability. We also have had instances where a large, geographically diverse retail deposit base reduced liquidity risk for weak institutions, thereby protecting them against failure.

Finally, to the extent interstate consolidation and branching reduced bank operating costs, bank profitability would increase. This would help banks build their capital accounts, directly contributing to overall safety and soundness.

Competition and Performance

Geographic restrictions represent barriers to market entry that may permit protected banks to perform less favorably in serving consumers and businesses. Bank customers pay for geographic barriers through higher prices for loans and other financial services, reduced locational and product convenience, and lower interest rates earned on deposits. A number of studies of geographic market barriers found that competition and bank performance improved with ease of market entry, resulting in lower prices, higher returns, and greater convenience for bank customers.

Efficiency and Cost Savings

A number of banking organizations and bank analysts argue strongly in favor of the cost savings that many bank holding companies could realize through consolidation via interstate branching. Banks could achieve these cost savings largely by reducing non-interest expenses, as duplicative functions were reduced. While the amount of savings may vary from one bank to another, we are convinced that very substantial efficiencies can be realized by many. Moreover, the fact that savings may vary across banks is not reason enough to deny banks an opportunity to realize these savings.

II. Concerns Raised by Liberalization

A number of concerns are commonly raised with respect to geographic liberalization. Included among these are that liberalization might: (1) lead to a decline in the number of small banks; (2) result in an excess concentration of resources; (3) siphon credit from local communities; and (4) damage the dual banking system. I would like to discuss these concerns further.

Decline in Small Banks

One of the most frequently voiced concerns is that interstate branching will inevitably reduce the number of small banks: large institutions will enter local markets and drive out, or buy up, small community banks. However, ample evidence indicates that this outcome is not inevitable or even likely. For example, in states where intra- and interstate geographic restrictions were significantly relaxed over the years, such as New York, small banks have continued to prosper.

Even in states that have long had liberal branching laws, small banks prosper and compete successfully with large banks. For example, hundreds of small banks, as well as many thrifts and credit unions, operate alongside banking organizations with their far-reaching branch networks in California, which has had unrestricted branching since the early 1900s. Other long-standing branching states, such as New Jersey and North Carolina, also have strong small bank communities.

Thus, fears about the viability of small banks and the maintenance of competition in the face of relaxed geographic restrictions are, we believe, ill-founded. Over the years small banks have been among the most profitable and best-capitalized banks in the nation. Well-managed small banks that know and attend to their customers' needs will not be displaced if

barriers to market entry are removed. Moreover, the availability of new bank charters will help to maintain a reasonable balance between large bank organizations and small, independent institutions.

Concentration of Resources

A long-standing concern with respect to the removal of geographic restrictions involves the potential concentration of banking resources and its effects on competition. While this concern cannot be dismissed lightly, new measures to limit concentration are not necessary, and would be extremely difficult to define by statute in a meaningful way. Despite progressive consolidation at the state and national levels, the level of concentration in local urban and rural markets has remained virtually unchanged for almost two decades. The federal regulatory agencies routinely examine bank merger and acquisition transactions for competitive effects, and this remedy will remain in effect in the event of further relaxation of geographic restrictions.

No Local Reinvestment

Another concern raised is that interstate branching may undermine the intent of the Community Reinvestment Act of 1977, and siphon funds from local communities. But interstate

branching legislation need not alter the CRA: all existing requirements for community reinvestment will remain intact and serve to ensure that banks meet local credit obligations. Moreover, no firm evidence indicates that branch banking is more likely than other banking structures to divert funds from local communities. On the contrary, the historical evidence shows generally higher bank loan-to-asset and loan-to-deposit ratios in jurisdictions with more liberal branching.

Indeed, the propensity to export capital or lend locally is unrelated to bank branching structure. For example, a community bank not wishing to lend locally -- or not finding sufficient local loan demand -- can sell Fed funds upstream to a correspondent bank, share in loan participations, or invest in securities rather than loans.

Finally, the siphoning argument amounts to a double-edged sword: a bank can also inject credit into an area, and bring funds into local communities. This is among the reasons why states liberalized their branching and interstate banking laws. That is, broader geographic expansion authority can produce more efficient credit distribution, including a greater flow of funds to communities where the demand for credit is greatest.

The Dual Banking System

An often-raised concern is that interstate branching will damage the dual banking system, but this should not happen. Current legislative proposals for interstate branching generally preserve states' authority to determine banking structure and otherwise regulate financial institutions within their jurisdiction. Under these proposals states would continue to control intrastate branching, by national and state banks, and to limit interstate branching by their own state banks. These proposals also permit states to impose on banks and branches within their borders certain state laws regarding fair lending practices, unsafe and unsound banking practices, and community reinvestment requirements (as if the bank were headquartered in the host state).

III. The Administration's Principles

As I mentioned earlier, the Administration generally supports the idea of further relaxing geographic restrictions. But in that process, we believe that certain principles should be adhered to. The principles include: (1) promoting efficiency and competition; (2) protecting safety and soundness; (3) meeting consumer and community needs; and (4) respecting the interests of the states. Additionally, we believe that any legislation in this Congress to further relax geographic restrictions should be

kept separate from other issues so that it can be considered on its own merits.

We believe it would be consistent with these principles to allow multi-state banking organizations to consolidate their bank subsidiaries. Consolidation would permit these organizations to structure themselves more efficiently, reducing overall banking system costs. And it would benefit consumers and businesses through lower costs and greater convenience in the market for financial services. Moreover, simply consolidating existing interstate banks will not change the amount of banking assets under common control, and does not raise new issues regarding concentration.

Indeed, we believe the issue of market share limits (and other concentration safeguards) demands further analysis. As I discussed in detail earlier, modern banks engage in a wide variety of activities in competition with a wide variety of non-bank financial intermediaries. Because of this, determining the appropriate limits on market share, or even the proper definition of market, can be complicated. Among other things, serious questions need to be answered involving the size of market, the range of institutions covered, and the degree of uniformity of limits across different jurisdictions. Without good answers to these questions, market share limits may not render the intended effect. For these reasons, we believe it is better to continue

to rely on reviews of merger and acquisition transactions by the appropriate federal agencies.

We are seriously concerned that any relaxation of geographic restrictions not undermine banks' obligation to serve their local communities. In this respect, it is useful to emphasize that all existing CRA requirements will remain in effect. Moreover, we support provisions for the applicability of state community reinvestment laws to the branches of out-of-state banks. A final concern here is that interstate consolidation of banks into branch systems may reduce the availability of information on banks in their communities. We believe an appropriate response to this concern is a separate CRA evaluation for each metropolitan area; this matter will be addressed in the new performance-based CRA approach currently being developed by the regulatory agencies.

Finally, any legislation enacted must provide foreign banks with national treatment -- the same competitive opportunities as U.S. banks.

IV. Conclusion

In conclusion, we believe relaxing current geographic restrictions could yield a number of benefits. Banks could benefit from greater efficiency. Businesses and consumers could

benefit from less costly financial services, higher returns on savings, and greater locational and product convenience. And the banking system could benefit from improved safety and soundness.

Mr. Chairman, I commend you and the other members of the subcommittee for the seriousness and commitment you bring to this important issue. We look forward to working with you to achieve our common objectives.

I would be pleased to respond to any questions you might have.

For Release Upon Delivery
October 26, 1993, 2:00pm

TESTIMONY OF

EUGENE A. LUDWIG

COMPTROLLER OF THE CURRENCY

Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION,

REGULATION AND DEPOSIT INSURANCE

of the

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

of the

U.S. HOUSE OF REPRESENTATIVES

October 26, 1993

INTRODUCTION

Mr. Chairman and members of the Committee, I appreciate this opportunity to testify on interstate branching. Markets for financial services have no natural geographic boundaries. Yet, banking firms are, for the most part, required to do business through separately chartered subsidiary banks in each state in which they operate. This inconveniences customers who bank in more than one state and drives up the cost of banking services.

Permitting banks to operate interstate branching networks should help improve the safety and soundness of the banking system and it should help banking companies provide more convenient and cost-effective service to their customers.

INTERSTATE BANKING TODAY

The authority of banking firms to provide services across state borders is currently limited by two provisions of federal law:

- The Douglas Amendment to the Bank Holding Company Act permits banking firms to acquire out-of-state banks only if the acquisition is explicitly authorized by the state in which the target bank is located. Every state has enacted legislation permitting some degree of interstate banking. But interstate banking under the Douglas Amendment must be conducted through separately incorporated subsidiaries of a bank holding company.

- Direct interstate branching is more severely restricted. The McFadden Act virtually prohibits interstate branching by national banks and by state banks that are members of the Federal Reserve System. Most states have enacted similar restrictions that apply to state-chartered banks that are not Federal Reserve members.

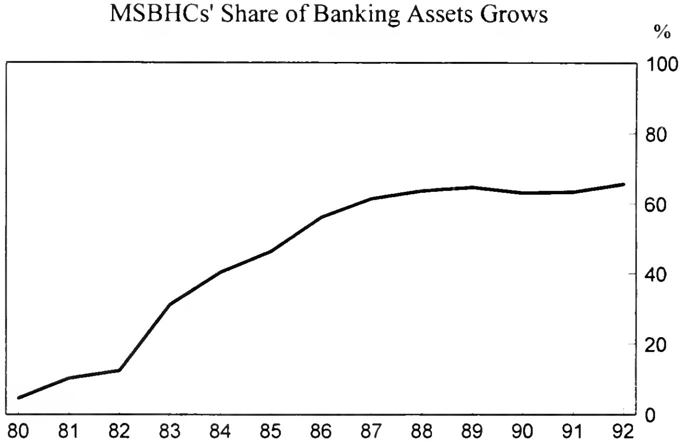
The constraints on interstate banking that these statutes provide are in many ways more nominal than real. As shown in the accompanying table, between 1980 and 1992, the number of banking companies with multistate operations increased more than tenfold, from 16 to 177. The number of banks they operated jumped from 279 to 1,277, and the volume of banking assets in those multistate companies rose from $85 billion to over $2.2 trillion, nearly 64 percent of all U.S. commercial banking assets.

The banking map of the U.S. today, shown after the table, tells a similar story. Every state in the nation has acted to permit entry by out-of-state banking companies, in one

Multi-State Bank Holding Companies Grow in Importance*

	# of MSBHCs	# of Banks	# of Branches	Assets MSBHCs ($B)	Total CB Assets ($B)	MSBHC Asset Share (%)**
1992	177	1,277	27,068	2,205	3,459	65.65
1991	174	1,295	26,980	2,144	3,383	63.38
1990	171	1,313	26,581	2,109	3,341	63.13
1989	160	1,403	25,537	2,103	3,251	64.69
1988	143	1,403	24,267	1,960	3,079	63.66
1987	132	1,438	22,399	1,824	2,969	61.44
1986	100	1,252	18,690	1,639	2,919	56.15
1985	65	720	12,514	1,259	2,718	46.32
1984	53	465	9,484	1,010	2,502	40.37
1983	33	317	6,193	729	2,338	31.18
1982	21	284	2,838	272	2,188	12.43
1981	18	277	2,348	208	2,028	10.26
1980	16	279	1,823	85	1,849	4.60

MSBHCs' Share of Banking Assets Grows

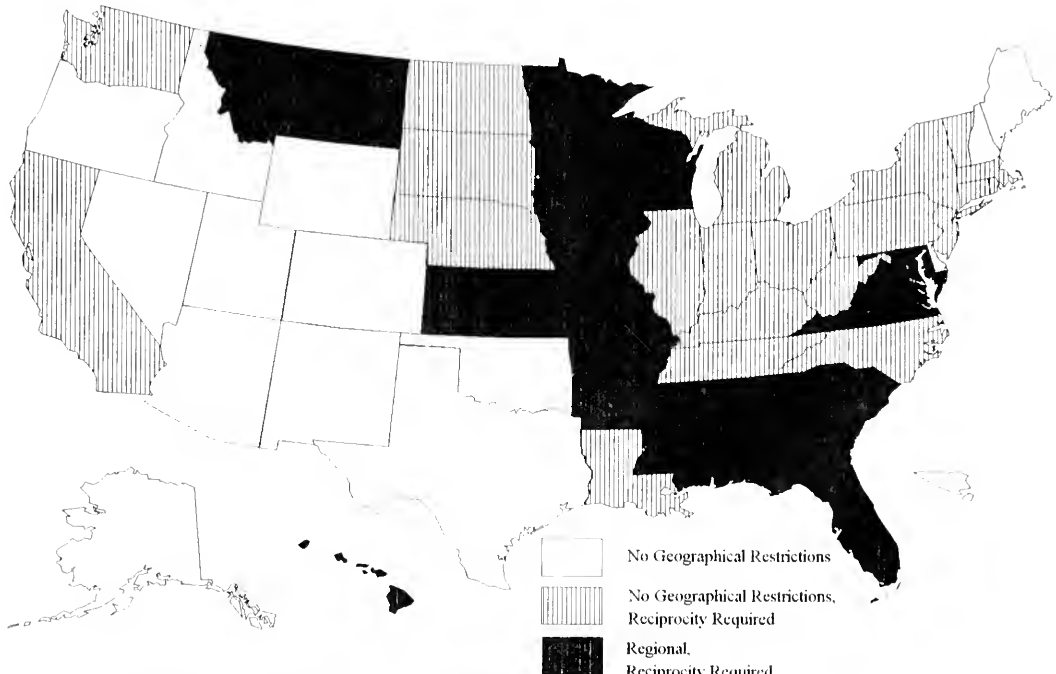


*Multi-state bank holding companies (MSBHCs) include all bank holding companies which have FDIC-insured commercial banks in at least two states. Number of branches excludes ATMs. Data are year-end

**Share of commercial banking assets held by MSBHCs

Source Call Reports

All States Permit Holding Company Entry
October 1993



Note: Classification is based on geographical restrictions, and qualifying entrants may have to meet other tests. Some states (e.g., Hawaii) have codes that require that instate institutions be given a chance to acquire failed banks before an out-of-state company may be offered that opportunity. See accompanying text.

Source: "A Profile of State Chartered Banking," The Conference of State Bank Supervisors, Fourteenth Edition, 1992, Table 11, p. 128; and Dean F. Amel, "State Laws Affecting the Geographic Expansion of Commercial Banks," August 1993.

Such erosion of artificial barriers to interstate banking is a natural outgrowth of improvements in information technology. As bank products have become more standardized and information processing technology has become more powerful and affordable, it has become easier for banks to provide services over increasingly large geographic areas. Bank customers have also become more mobile. Rather than conducting all of their banking business at a single branch, they now demand access to banking services wherever they are, often in places other than their home state.

While interstate banking has grown steadily and broadly over the last decade, interstate branching--the opportunity to have branches, rather than subsidiary banks--in multiple states has lagged far behind. To date, only nine states permit interstate branching. They are scattered across the U.S. and include Alaska, Connecticut, Massachusetts, Nevada, New York, North Carolina, Oregon, Rhode Island, and Utah. All but Utah require reciprocation by the state that headquarters the bank seeking entry. Because of the McFadden Act, only state banks that are not members of the Federal Reserve System may take advantage of those laws. Thus, the interstate branching movement needs a helping hand.

A PRESCRIPTION FOR CHANGE

Giving a well-structured boost to interstate branching is not a simple task, for it requires a careful weighing of several important factors. In taking on that challenge, I find it useful to apply the two-part test that we should apply to all new banking activities generally. To be permissible under this test, a new activity:

- should not adversely affect safety and soundness; and

- should, on balance, benefit consumers of financial services--large and small businesses as well as individuals.

A fair application of this test clearly implies that federal law should permit interstate branching. For that reason, Secretary Bentsen yesterday announced the Administration's support for a change in federal law that would give interstate banking companies the opportunity to consolidate their banking subsidiaries into branching networks, with the approval of the appropriate state. Within each branch system, customers would be dealing with the same bank in every state and could make withdrawals and deposits in any branch and still have all transactions recorded as part of their account at the surviving bank, wherever it might be located. The banking organization itself would be more efficient, in part because all the branches would have common policies and operating procedures.

As outlined by the Secretary, this reform should not threaten the dual banking system. As proposed, banking companies would not be permitted by federal law to establish de novo branches across state lines, although states would be free to permit entry by branching as they are today. As proposed, only the states could decide whether or not out-of-state banking

form or another.[1] Although many states restrict the circumstances under which entry may take place, those circumstances are not, generally, geographical in nature. In fact,whatever limitations they may impose, thirty-five states permit entry by banking companies from any other state either on a reciprocal or unrestricted basis. The remaining fifteen states and the District of Columbia permit entry, all but Hawaii on a reciprocal basis, by banking companies headquartered in nearby states.

The willingness of states to open their borders to out-of-state banking and the consequent growth in multistate banking companies has taken place against a background of important activity at the federal level. To facilitate the resolution of failed banks, Congress, beginning with the Garn-St Germain Depository Institutions Act of 1982, permitted holding companies to acquire closed banks with assets in excess of $500 million on an interstate basis notwithstanding state law. Congress expanded this authority in the Competitive Equality Banking Act of 1987 to include, among other things, the emergency acquisition by out-of-state banking companies of banks that are in danger of closing and that have assets in excess of $500 million. Congress also has authorized the Resolution Trust Corporation to override state laws, including branching laws, to facilitate the acquisition of failed thrifts by banks.

In addition, federal thrifts may engage in unrestricted interstate branching, subject to certain exceptions, in accordance with rules of the Office of Thrift Supervision finalized in May of 1992.

Whatever stimulus for change federal activity may have provided, market pressures were clearly at work. For many years, national banks have been establishing loan production offices where they could not establish branches, in order to serve customers operating in more than one state. National banks also may permit customers to have access to withdrawal services, and in some cases deposit services, without geographic limitation by joining interstate ATM networks.

More recently, various forms of home banking, electronic banking, point-of-sale terminals, banking by mail, and use of third party messenger services have also enabled banks to expand the geographic range of their services consistent with current law. Some banks in many states now provide deposit account services through tellers, similar to those that can be provided by an ATM machine, to customers of intrastate affiliated banks. Some banks are also considering providing such accommodation services on an interstate basis.

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[1] Restrictions some states impose upon entrants include barring de novo entry, limiting acquisitions to failed banks, requiring that acquired banks be older than some specified number of years, and requiring that a specified percentage of the assets of the acquiring company be located in a specific region. Hawaii, for example, limits out-of-state entry to banks headquartered in selected U.S. territories and to acquisitions of failed or failing banks by banking companies located in the twelfth Federal Reserve District, but only after all Hawaii banks have turned down the opportunity to buy the failing bank.

companies could convert existing subsidiaries into branches. State laws would also control the terms and conditions of additional branching within the state by banking companies that converted their banks to branches, as they do today.

I will now discuss why interstate branching, as we envision it, meets my two-part test.

BANK SAFETY AND BANK CUSTOMERS

Bank Safety

There are several important elements to bank safety. Interstate banking has permitted banking companies to diversify their asset portfolios and their sources of income more fully, reducing the impact of an economic shock in any particular region, and providing a greater margin of safety to the bank and its deposit insurer. Moving from interstate banking to interstate branching increases the ease of accomplishing further diversification.

However, the greatest additional safety and soundness advantage afforded by interstate branching is lower costs. By reducing operating costs, interstate branching would increase returns on equity, directly strengthening the industry's bottom line. Indeed, consolidation of multibank holding company bank subsidiaries into branches would generate cost savings in a variety of ways. It would eliminate the need for multiple charters, boards of directors, and administrative structures; facilitate the consolidation of back-office operations; and allow banks to achieve greater economies in the advertising and marketing of financial services.

Consolidation of banks into interstate branching networks would also reduce the burden of complying with government regulation by decreasing the number of regulatory reports that the bank must file and the number of requests for information that it receives from its supervisor. For example, each quarter, every bank submits a Report of Condition and Income (Call Report). Those reports are approximately 30 pages long and include about 600 items for banks with over $100 million in assets and about 400 items for smaller banks. Thus, a multibank holding company with 10 separate affiliate banks submits 10 reports each quarter. If a multibank holding company could consolidate its banks into a single bank with branches in several states, it would have to provide only one set of information, not several sets. Savings such as these would complement current efforts by the OCC to reduce unnecessary regulations.

To the extent that banks achieve the potential cost-savings available to them, they will be that much stronger. Consolidation of operations into branches would leave the banking firm's consolidated balance sheet unchanged; it would not add in any way to the risks of banking. Instead, by reducing operating costs and increasing the convenience and value of banking services, consolidation should improve the financial condition of national banks. By

realizing cost savings, banks will be able to augment capital, directly improving safety and soundness.

Supervising Interstate Branching Networks

An important part of bank safety is, we would all agree, effective bank supervision. I believe that interstate consolidation would not present supervisory challenges that the OCC does not already face in supervising large multibank companies. Money-center and super-regional banking firms have complex and far-flung operations that often extend over several states and more than one OCC supervisory district. We have met the supervisory challenges posed by those banking companies. The switch from multibank holding companies to consolidated interstate banks could ultimately reduce the severity of these supervisory challenges and allow us to concentrate our resources further on reducing systemic risks to the banking industry and eliminating unfair, deceptive, and discriminatory lending practices.

Our experience in the supervision of large multibank organizations has also prepared us well for supervising consolidated interstate branch networks. Our objectives in supervising national banks involve: assessing the condition of each bank and the risks associated with its current and planned activities; determining if risk management systems exist, and if those systems are properly designed; communicating with bank management and board(s) of directors in a timely and clear fashion about our supervision, the findings of supervisory activities, and those matters that require corrective or remedial attention; causing banks to correct deficiencies in condition and/or risk management systems; and validating the correction of deficiencies. The organizational structure used by the financial institution to provide banking services, whether a multibank holding company or a consolidated interstate bank, does not alter these basic supervisory objectives.

Consolidation of interstate operations of multibank holding companies should also provide net operating efficiencies to the regulatory system as a whole. Federal law requires the OCC and the other federal banking agencies to conduct annual examinations of each bank within its jurisdiction. The elimination of the need to maintain separate charters in each state in which financial institutions operate will likely reduce the total number of banks within any given organization and, therefore, reduce the number of separate examinations the regulatory agencies are required to conduct each year. Importantly, a potential reduction in the total number of chartered entities examined will not undermine safety and soundness. Consolidation should permit the supervisory agencies to focus more sharply on the risks to the organization as a whole, to conduct a more efficient review of overall asset quality, and to provide a truer picture of the condition of the institution.

Consolidation may also promote efficiencies in the performance of each examination. For example, the switch from a multibank holding company to a consolidated interstate bank will reduce the total number of directors, officers, and other insiders in any given financial institution and, therefore, make it easier to identify and take corrective action for violations of insider regulations. These changes can only improve bank safety and soundness.

Consumer Benefits

While the primary benefits of interstate banking consolidation would be in the form of lower bank costs, the potential for some important consumer benefits also exists. Although the evidence is somewhat mixed, it appears that interstate banking has benefitted consumers by increasing competition and expanding the array of financial services. Even so, there is much room for improvement. Currently, banking is not as convenient as it could be for consumers who frequently travel across state lines. For example, a customer of a bank in New Jersey located near his or her home may not be able to obtain, conveniently, banking services at an affiliated bank in New York City located near his or her place of work. Consolidation of separately chartered banks into branches under a single charter would make it much easier for customers to conduct transactions at any branch throughout the entire service area of the consolidated bank.

While we believe that interstate branching through consolidation of commonly owned banks is good policy, in part because it will benefit consumers, consumer protection must remain a high priority for bank supervisors.

CONSUMER PROTECTION

The Administration is committed to ensuring that the benefits of a safe and sound banking system extend to all segments of society. Finding better ways to encourage banks to invest in their local communities is a key part of that commitment, particularly with expanded interstate branching.

CRA regulations require banks to address the credit needs of their delineated communities. As banking firms consolidate their operations, the responsibilities of individual banks under the CRA will naturally multiply, and bank supervisors will have to find ways of ensuring that banks that have branches in widely separated areas help meet the credit needs of all of the communities they serve. Interstate branching should not impair CRA performance.

This is a challenge that we can surely meet. It is the same problem that federal banking agencies and banks already face in crafting meaningful CRA evaluations in states that permit statewide branching. This is one of the issues that the federal banking agencies are currently reviewing as part of the President's initiative to make fundamental changes in CRA administration. I believe that the revised CRA evaluation process will provide an appropriate model for assessing the performance of banks with interstate branches.

For all of its importance, CRA is not the only federal protection of consumer interests. Other protections are provided by laws extending from the Equal Credit Opportunity to Fair Housing to Truth in Lending and Truth in Savings, just to name a few. As in the case of CRA, bank supervisors have had ample experience in enforcing those laws with respect to

large intrastate branching networks. We are prepared to enforce them with respect to large interstate branching networks.

Service to the community is not, of course, defined exclusively in terms of adherence to consumer protection and related laws. It is also defined in terms of the personalized service that is the hallmark of small community banks. We are confident that community banks will continue as strong competitors in an era of interstate branching.

When large and small banks compete in the same geographic markets, good management--not size--is the primary determinant of a bank's success. Pennsylvania, for example, moved from highly restrictive branching to full intrastate branching during the 1980s. Small banks continue to operate successfully there. As of June 30, 1993, there were 139 national banks in Pennsylvania, 60 of which had assets of less than $100 million. All of those banks were well capitalized.

Consequently, we expect community banks to retain their traditional role in local credit markets, and credit-worthy local borrowers should continue to be able to obtain the financing they need. Successful banks traditionally have been those that best meet the needs of the markets they serve. Competitive forces have led many large banks to become adept at providing a high volume of services at low cost, but this advantage is generally limited to products that do not require a high degree of personal service. Many small banks, on the other hand, have excelled at providing high-quality, personalized services to their clients. This is particularly true of small business lending, which requires knowledge about small borrowers and local credit conditions that community banks are more likely to possess. Local customers who value customized service are therefore likely to continue to seek the financial services of smaller banks, whether or not a branch of a large bank is located across the street.

Finally, we must continue to ensure the proper application of the antitrust statutes to banking. I am aware of some studies that argue that interstate branching will lead inexorably to higher concentration ratios and reduce competition in local banking markets. While intuitively appealing, many recent studies have not found strong evidence in support of those claims. In fact, between the mid 1970's and 1990, the percentage of deposits in urban and rural markets held by the three largest banks in those markets dropped slightly, on average.[2]

Research by OCC economists also suggests that interstate branching will not inevitably lead to reduced competition. Rather than relying upon statewide concentration ratios, OCC staff computed the Herfindahl-Hirschmann concentration index (HHI), a measure of concentration preferred by many researchers.[3] We calculated deposit-based HHIs for banks

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[2] Statement by John P. LaWare before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, October 5, 1993.

[3] In contrast to typical concentration ratios, HHIs take into account the market share of all institutions the researcher is studying, not just the largest ones.

and thrifts in 29 urban markets in Indiana, Oregon, South Carolina, and Washington for the years 1988 through 1992. We chose those states because they witnessed significant entry by out-of-state banking companies in recent years. Over the four-year period, HHIs declined in 14 of the 29 markets; for the remaining 15, the median increase was under eight percent. While our study is far from comprehensive, it does not indicate that local market concentration has increased rapidly in states with considerable acquisition activity by out-of-state banking companies.

CONCLUSION

For many years, observers both inside and outside government have pointed out the need to remove the archaic restrictions placed on the U.S. banking system. Our banking system would function more efficiently without them and would be better positioned to meet the convenience and needs of the banking public. Interstate branching would be an important step in that direction, permitting banks to serve their customers better and at lower cost, while enhancing the safety and soundness of the banking system.

U.S. HOUSE OF REPRESENTATIVES

SUBCOMMITTEE ON CONSUMER CREDIT AND INSURANCE
OF THE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

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Kennedy Calls for Stronger Consumer Protections On Interstate Banking Legislation

October 26, 1993

Rep. Joseph P. Kennedy II (D. - MA), Chairman of the House Subcommittee on Consumer Credit and Insurance, made the following statement today in response to testimony delivered by Administration officials regarding interstate banking:

"I strongly support interstate banking legislation, and commend Chairman Neal, Undersecretary Newman, and Comptroller Ludwig for their efforts to advance it. It will improve safety and soundness by diversifying lenders' asset bases, increase efficiencies in the system, and promote healthy competitition among banks and with non-bank financial institutions.

"However, I believe that any such legislation must include stronger consumer protection measures than those laid out by the Administration over the last two days. We must modernize all our laws to keep pace with changes in the banking system, including consumer protection laws. For instance, we should be sure that deposits will be used to invest on Main Street, not Wall Street. That means ensuring that interstate lenders have a good CRA track record, and that they spell out in detail how they will meet credit needs in new communities that they wish to enter. That also means requiring regulators to examine a lender's CRA performance by metro area, not simply nationwide, to ensure that all components of an interstate network are meeting local credit needs. I'm pleased that the Administration appears to support this latter reform.

"In addition, we must ensure that state consumer banking laws aren't the hit-and-run victims of lenders barelling down the interstate highway. Many states now have laws requiring basic banking, community reinvestment, and government check cashing services. Any legislation that the Congress adopts should protect these and other important state laws from preemption.

"Finally, we should ensure that any interstate lender discloses loans to small and minority-owned businesses. This modest change will allow the public, regulators, and policymakers to make certain that lenders are taking care of consumers in their own back yard, even as they venture into new and far-off markets."

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